



Munich Personal RePEc Archive

Article Review on World Bank Report, Optimal Design for a Minimum Wage Policy in Malaysia

Nurrachmi, Rininta and Mad-Ahin, Ashanee and
Waeowanjit, Phimpaporn and Kareemarif Arif, Naz Abdul

Departement of Economic. International Islamic University Malaysia

December 2012

Online at <https://mpra.ub.uni-muenchen.de/44618/>

MPRA Paper No. 44618, posted 27 Feb 2013 14:03 UTC

ARTICLE REVIEW

“Optimal Design for a Minimum Wage Policy in Malaysia”

The World Bank report, July 28, 2011

By

Rininta Nurrachmi¹

Ashanee Mad-Ahin

Phimpaporn Waeowanjit

Naz Abdul Kareemarif Arif

ABSTARCT

There are many pros and cons with the implementation of minimum wage in Malaysia, since it is the first time. This article review is to analyze the World Bank report on Malaysian minimum wage policy that will be implemented in 2013. There are strength and weakness on the report. Moreover the review will also be analyzed from Islamic perspective since majority population in Malaysia is Muslim.

1. INTRODUCTION

The objective of minimum wage from economic perspective is to help workers receive compensation which suit with their productivity in imperfect labor market. However in the practice there are many advantages and disadvantages for countries who implement minimum wages.

Malaysia as a country who has many migrant workers has set the minimum wage for the first time. There are pros and cons regarding the minimum wage policy set up and the World Bank has issue a report entitled “Optimal Design for a Minimum Wage Policy in Malaysia”.

There will be trial and error for Malaysian government in implementing this policy for the first time and the purpose of the World Bank issue this report is to assist the

¹ Corresponding email : rini.martam@gmail.com

government in the practice. Furthermore, three distinct labor markets namely Sabah/Labuan, Sarawak and Peninsular Malaysia has different minimum wage according to the economic condition whereas there are RM 900 for Peninsular Malaysia and Sarawak and RM 1100 for Sabah / Labuan.

The objective of this paper is to review the report issued by the World Bank and elaborate the suitable analysis from Islamic perspective. Moreover, the authors will examine the strength and weakness depict in the article.

The remaining part of this paper will be structured into 4 parts. Part two will elaborate the summary of the article. Chapter three comprises the critical reflection in regards toward the strength and the uniqueness and the weaknesses. covers survey from the related article. Chapter four will sum up the result in the paper and recommendation. Lastly bibliography provides a list of all sources employ as reference materials during the writing process.

2. SUMMARY OF THE REPORT

The minimum wage is a labor market institution used in the majority of countries the world over. Due to its importance, it should be controlled by the government to improve the circumstances of the working poor and vulnerable. The main condition of minimum wage policy is to be high enough to meet the basic essentials and requirements of the worker.

The concern on the implementation of the minimum wage policy revolves around its impact on employment, training & productivity, inflation and the country's competitiveness. Usually, the employers using economic theories, argued that wages for labor should be determined by market forces at the interaction point of the supply & demand curves, any attempt at setting a minimum wage higher than that determined by the (assumed) efficient market, would lead to a distortion in the economy.

Recently, Malaysia's Ministry of Finance partnered with the World Bank assess whether a minimum wage would be suitable for the country. On 30 April 2012 Malaysia issued details of the minimum wage to complements the National Transformation Policy that is meant to drive Malaysia towards becoming a high-income nation. Malaysia cannot be a develop nation if a significant portion of its workers have salaries that keep their household income below the poverty line. The findings of that assessment were that it made sense for the government to consider introducing a minimum wage to address failures in labor markets that could reduce competition and depress wages. However, the assessment warned that careful attention would need to be given to how the policy was designed and implemented. Following up on those initial discussions, the Ministry of Human Resources has asked the World Bank for technical assistance in designing and implementing a minimum wage policy that would suit the Malaysian economy.

In general, The achieving goals of minimum wages vary between nations, but overall the possible objective are (i) reducing poverty or inequality by increasing the wages of low-income workers; (ii) promoting productivity growth; and (iii) addressing efficiency issues in labor markets that reduce employment and increase profits at the expense of workers. The minimum wage policy effective tool to reduce the poverty, promote the productivity and addressing efficiency issues, as we can see below:

In case of poverty/ inequality: To fulfill the objective of the minimum policy, increasing low level of wage lead to decreasing the level of the poverty. But, there are many arguments about the reason to low wages, the main argument made by various stakeholders during the Minimum Wage Lab held in Putrajaya in February 2011: first, Wages can be low simply because labor productivity is low. This may occur as a result of low capital intensity per worker, inefficient production technologies, and/or the low quality of the labor force. Problems with education and training systems or constraints in the business environment can

be the cause. Second, the minimum wage can increase the salaries of eligible workers but does not necessarily improve equity in the population. If the negative employment effects on other low-skilled workers are large and/or if the earnings of middle-income workers also go up, a minimum wage can do more harm than good and even reduce net income for low-skilled workers. Akerlof (1982) argues that raising wages can stimulate worker effort and strengthen long-term employment relationships. High wage workers are less likely to quit. Thus firms can retain more experienced and productive workers than newly hired workers who may not be as productive as experienced workers.

As result, applying minimum wage policy may have negative impact. For example: workers in Sabah have mid-low levels of productivity but they face very high costs of living. If government wants to use the minimum wage to address poverty, the level in Sabah would have to be over RM1300, and a disproportionately negative effect on employment, leading to job losses and more poverty, is very likely at such a high level.

Furthermore , the objective of promoting productivity growth, some policymakers have suggested that a minimum wage might give firms an incentive to upgrade production technologies and increasing productivity in order to maintain profits. However, the international evidence does not support this view. For instance, increasing the cost of labor by introducing a minimum wage will increase companies' operating costs. Although some firms might react to this increase by reducing redundant expenditures and increasing their efficiency, others might simply see their profits fall or go out of business. Enhancing productivity is indeed a desirable objective, but there are better tools for attaining it than simply increasing labor costs, including investing in education and training for the workforce, promoting research and development, increasing access to capital, and improving the business environment generally. Regarding to other study as Wakeford (2004) *assume the* marginal productivity theory suggests that highly productive workers are highly paid, and

less productive workers are less highly paid. Higher productivity in turn could cause the wages to rise. Therefore, it is hypothesized that productivity has a positive impact on wages.

Lastly, to addressing the efficiency in the labor market: A minimum wage can be justified, instead, when low wages are due to non-competitive labor markets. In non-competitive (or monopolistic) markets, employers have more bargaining power than workers and may be able to keep wages low (in other words, ensuring that they pay wages below the marginal productivity of labor). In this case, a minimum wage can be used to increase the wages of low-income workers with no negative impact on employment. Most countries around the world including Malaysia are not fully competitive in labor market. In contrast, the perfectly competitive labor market firms have limited (if any) power to set wages, thus relying on the market to determine competitive wages. Firms in such an environment rarely deviate from paying the market wage to avoid losing workers and in cases when they pay more they sustain losses and eventually have to exit the market.

Next, the report of the World Bank gave an overview of current Malaysian labor markets by explain some features of the labor market. Malaysian labor market as many other countries not fully competitive market .As well as, it is impossible to refute the existence of monopsony power in Malaysia, there are several pieces of descriptive evidence that suggest that workers may not be recovering a fair share of their productivity through wages.

Moreover, the most Dimensions to Consider When Implementing a Minimum Wage have been determine by this report is structure and coverage including variation by region, sector, and/or age as well as Exemptions by type/size of firms.

Structural differences in the labor markets in different regions and across economic sectors. The existence (and growing presence) of the informal sector in Malaysia. It will also be important to determine whether having a uniform minimum wage for all workers is likely to reduce employment for young (less skilled) workers, especially if the mandated level is too

high relative to current average earnings for this group. It will be important to focus on migration and its effect, on study made by Athukorala & Devadason (2012) *focus on the role of migration*, an important feature of international migration over the past half a century has been the growing importance of temporary labor migration, mostly the migration of semiskilled and unskilled workers, compared to permanent (settlement) migration. Malaysia is the biggest net importer of labor in Asia with a migrant labor force of around 2 million (21% of the total work force) as of 2008. The finding of the study is statistically significant negative impact of foreign worker dependency on real manufacturing wages.

The impact of the minimum wage on the Malaysian economy will depend on the structure of the country's labor markets. However, the impact on different groups of workers will vary depending on what production technologies are being used and, in particular, on the degree of substitution that is possible between types of skills and between formal and informal jobs. The possible effects of a Minimum Wage on employment, investment and migration are as follow:

- The impact of minimum wage would be minor in a reduction in formal employment and an increase in informal employment. (Minimum that is too high can substitute formal By informal labor)
- the negative effects are mainly concentrated among young and low-skilled workers especially women
- On the other hand, in term of high-skilled workers, adults would be more vulnerable than youth depending on the demand for their skills.
- The impacts of minimum wage on investment are also likely to be minor. It would only be affected if the minimum wage were set higher than RM900 and no change in investment if the minimum wage were set at RM700.

- The case study in Indonesia showed that a high minimum wage is not likely to cause existing foreign-owned firms to exit or reduce their stake holdings. Thus, Malaysia which has significantly more capital-intensive manufacturing than Indonesia in its overall FDI is unlikely minimum wage to have much of an effect on FDI.
- There are other factors than wage cost which are more important for FDI inflow considering such as labor taxed, employment protection, protection of property rights, ease of market entry and exit, low corruption, etc.
- In term of migration, minimum wage would cause the decline in the demand and employment opportunities for migrant workers.

The Institutional Set-up: Policy Design, Implementation, and Enforcement, the World Bank elaborate the policy design of minimum wages by reviewed from five countries namely Chile, Hong Kong, South Korea, Taiwan and Thailand. The World Bank divide it into nine section, they are background, the objective of the minimum wage law, legislation, coverage, governance of the minimum wage, the criteria for setting the minimum wage, frequency of revisions, enforcement and other lessons and challenges learned from the case studies. It also show simulated impacts on the economy when minimum wage is implemented at various levels and on various sector.

The World Bank mentioned that from the countries studied that minimum wage should be one in a nation however in the case of Malaysia with three distinct labor markets, economic justification is use for considering a regional adjustment. Moreover, in this part the World Bank mostly recommends Malaysia how to implement the policy.

The prominent recommendation are foreign workers should deserve to be given the same treatment under labor law as Malaysian workers because their contributions to the Malaysian economy and also establishing the NMWC (New Minimum Wage Council) in

order to conduct the regular review process and to make recommendation about the level of the wage.

The Institutional Set-up: Policy Design, Implementation, and Enforcement, the World Bank elaborate the policy design of minimum wages by reviewed from five countries namely Chile, Hong Kong, South Korea, Taiwan and Thailand. The World Bank divide it into nine section, they are background, the objective of the minimum wage law, legislation, coverage, governance of the minimum wage, the criteria for setting the minimum wage, frequency of revisions, enforcement and other lessons and challenges learned from the case studies. It also show simulated impacts on the economy when minimum wage is implemented at various levels and on various sector.

The World Bank mentioned that from the countries studied that minimum wage should be one in a nation however in the case of Malaysia with three distinct labor markets, economic justification is use for considering a regional adjustment. Moreover, in this part the World Bank mostly recommends Malaysia how to implement the policy.

The prominent recommendation are foreign workers should deserve to be given the same treatment under labor law as Malaysian workers because their contributions to the Malaysian economy and also establishing the NMWC (New Minimum Wage Council) in order to conduct the regular review process and to make recommendation about the level of the wage.

3. CRITICAL REFLECTION

3.1. The Strengths and The Uniqueness

The report has asserted comprehensive information for the readers and Malaysian government in particular. It could be used as a guideline or input for Malaysian government in the case of implementation of minimum wage policy. Whereas, the policy is apply for the first time in Malaysia.

3.2. The Weaknesses

Some weaknesses can be found in this report. That is, The World Bank report, focuses its simulation on 28 economic sectors, like agriculture, urban services, food production, wood manufacturing, without distinctions for whether they are big or small. Thus, analyzing the result would be vague as it is not clear that the negative impacts of minimum wage are largely concentrated for small, medium or large businesses.

Malaysia is a member of commonwealth, Muslim majority and applied federal constitution monarchy in the South East Asia, and the World Bank did not represent it in the countries used as analysis for minimum wage namely Thailand, Chile, Hong Kong, South Korea and Taiwan. Although there are many foreign workers in Hong Kong, South Korea and Taiwan, the system will be different. Thus the overview of the analysis will be vague.

Moreover, the report covers the perspective in conventional framework because the point of view comes from the west or developed countries.

4. A SURVEY OF RELATED ARTICLE

The paper “Does the Minimum Wage Affect Employment? Evidence from the Manufacturing Sector in Indonesia” by Ximena Del Carpio, Ha Nguyen, Liang Choon Wang (2012) is part of a larger effort by the World Bank to provide open access to its research and make a contribution to development policy discussions around the world. This paper investigated the impact of minimum wage on employment and wages offered by Indonesian manufacturing firms by using firm panel data (from the Indonesia industry survey) from 1993 to 2006. The authors pointed out that since there are many more small firms in Indonesia, the aggregate effect of the minimum wages is to have an overall negative effect on formal employment, i.e. they lead to job losses. Hence, the results have shown that the minimum wages have negative employment effects on small firms but not on large firm. In addition, their analysis show that the job losses are primarily driven by those among less skilled or low-production workers than high skilled workers and the vulnerability is more accentuated for women than men. In other word, most of the low-production job losses are experienced by female workers. Lastly, the authors suggest and emphasize that, the fact that this and other studies yield varying results regarding the effects of minimum wages on employment should not come as a surprise given that there are structural differences between countries and there is wide variation in the way minimum wage policy is designed and implemented. Thus, results from this and other analysis undertaken in other developing contexts should not be interpreted to indicate that minimum wages are bad under all circumstances; instead, the interpretation should be that the effect of a change in minimum wages on employment can be sensitive to the context in which it is implemented.

In term of Islamic perspective, there are only few articles (Akhtar, 1992) discuss minimum wage in Islamic field, mostly the articles mentioned about the relations between employee and employers in Islam. Although his article “An Islamic Framework for

Employer-Employee Relationships” elaborate the detail regarding minimum wage in Islam. He asserts that the wage rate should be high enough to take care of the employee’s need such as basic material need as food, clothing and shelter. He allows government intervention in order to redress workers’ grievance. However, he stated that if the minimum wage is inadequate to meet the basic needs of a worker’s family, the deficit will be met through zakah revenues. This statement is not mentioned in the report, it would be suitable for Malaysia whereas Zakah institution plays an important role in the Malaysian economy.

Furthermore, he stated that Islam concerns to guarantee one’s basic needs, ensuring humane working loads and working conditions, and extending brotherly treatment to employees. In this context, he recommends minimum wage laws. In addition, Islamic law requires that the contract’s details be written out and witnessed by a neutral party. Any contract not specifically prohibited by Islamic law is valid and binding on the parties and must be enforced by the courts. All contracts have to qualify certain conditions, or else the contract becomes void.

In the reports of the countries which are reviewed as guidelines (except Chile) specify requirements for the membership of tripartite recommending committees and their tasks as well as guidelines for how they should operate. Those statements are in line with Akhtar (1992) in the context of Malaysia whereas an Islamic state should determine minimum wage through a process of tripartite negotiation where employers and the state are equally represented and rules are laid down to ensure that workers receive their due.

One of the main goals of an Islamic economy is to fulfill the basic needs for all human beings; this purpose is guided by the Shari’ah, which promotes Masalih al -Ibad (the welfare of human beings) (Siddiqi, 1992: 4; Ruzita Mohd. Amin and Selamah Abdullah Yusof, 2003).

1. Minimum wage resembles essential wage to fulfill sufficiently the basic needs in life (Daruriyat) without overburdening himself. (Muhammad Umer Chapra, 1983). That is,

the minimum wage rate in an Islamic society will be determined by keeping in view the basic human needs which include food, clothing and house and also be provided for children's education and medical treatment of his own self and his family. Thus, a worker shall be paid enough wages that he can meet expenses on his and his family's, (MuhammedAbdullahi, 2011). According to hadith, the Prophet, 'an employee (male or female) is entitled to at least moderately good food and clothing and to not being burdened with labour except what he (or she) can bear (Malik,v.2,p,980:40;Chapra,1983). From this hadith it may be inferred that 'minimum' wage is wage for an employee to get a sufficient quantity to reasonably good food and clothing for himself and his family without overburdening himself. This was considered by the Prophet's Companions to be the minimum even to maintain the spiritual standard of Muslim society (Muhammad UmerChapra, 1983).

2. Using minimum wage law as intervention in the labor market for protection the interest of worker when market imperfection exist, (M.RamzanAkhtar, 1992). As well as promotion Masalih al-Ibad (the welfare of human beings). It follows, therefore, that in normal circumstances the Islamic state should not intervene in the market for the purpose of fixing wage or price. However, if market imperfections exist, then the state can intervene for the sake of enforcing *qimal al mithl* (intrinsic price), but only for an interim period. As soon as the imperfections are removed, the state-regulate price or wage is to be discontinued and the market-determined price or wage is to prevail once again. Looking at the real condition of workers in many contemporary Muslim countries, it appears that many are living at a very low level of economic life. For instance, the average nominal monthly wage of an industrial worker in Pakistan was Rs.496 during 1975-79, namely, a low level of wage earning on the part of employees so, state was suggested in intervention (M.RamzanAkhtar, 1992). According to once during the time

of the Prophet, price shot up, the companions of the Prophet asked his permission to make a proposal. The proposal was that under the circumstances, it seemed desirable for the Prophet to fix the price for us. The Prophet said that ‘Allah is the sustainer. He expands and contracts the sustenance. He fixe the price. It is my wish that I may be presented to His court on the condition that I owe nobody’s right and, hence, there is no demander of his right from me; and I have done excess to nobody who wants to seek his recompense from me, (Abu Dawud,v.3, Dar ulFikr, p,272;M.Ramzan Akhtar, 1992). Thus in case, imperfect labor market (minimum wage is insufficient for expenses in basis needs), the minimum wage rate policy is functional of the principle in efficiency. Therefore, the role of the market mechanism in determining wage should not begin less than the level of minimum wage.

5. CONCLUSION

Most countries around the world have some form of minimum wage, and policymakers have often argued that the minimum wage, by increasing the income of low-income workers, can be used as a tool to reduce poverty and inequality. The Malaysian government’s concern to improve the circumstances of the working poor and vulnerable is valid and merits immediate attention, however, worldwide evidence shows that even though a well implemented minimum wage that imposes a moderate (and economically reasonable) level can have positive social welfare effects it is not the most appropriate instrument to address poverty and inequality. Indeed, many poor people are not employed or are employed in the informal sector where minimum wages are not binding. Also, poor people often have limited skills and low productivity and thus tend to be among the first to be laid off when wages increase in line with the legislation. Thus, the minimum wage policy is not a guarantee of better things to come. It has to be matched with hard work, innovation and vigilance.

Labor productivity has to improve consistently across the board. More importantly, the government should pay careful attention to how the policy is designed and implemented as well as should consider adopting other policies consistently to ensure and become driving force leading to its goal of protecting workers while minimizing any negative effects on the labor market and on the competitiveness of the Malaysia economy.

Islam encourage minimum wage as one of the important tools that help to fulfill basic need of the employee , to reduce poverty and to achieve the equivalent of distribution in the society. However, a tool as minimum wage should be seriously implemented together with other Islamic important tools as Zakat ,Waqaf, etc in order to achieve Maqasia al-Shariah and one should hasten to add here that the ultimate goal of Islam in this respect is the establishment of justice.

REFERENCES

- Akerlof, G. A. (1982). Labor contracts as partial gift exchange. *The quarterly journal of economics*, 97(4), 543-569.
- Akhtar, M. R. (1992). An Islamic Framework for Employer-Employee Relationships. *The American Journal of Islamic Social Sciences*, 9(2), 202–218.
- Athukorala, P., &Devadason, E. S. (2012). The Impact of Foreign Labor on Host Country Wages: The Experience of a Southern Host, Malaysia. *World Development*.
- Kristensen N. and Cunningham W., (2006) and W. Cunningham, (2007). See also Gindling and Terrell (2004), and Bosch and Manacorda, (2010).
- Maximization: An Islamic Perspective” *Review of Islamic Economics*, No. 13, 2003, pp. 5—21
- M. RamzamAkhtar, An Islamic Framework for employer-employee relationship, *The American Journal of Islamic Social Sciences*, 1992
- Muhammad Umer Chapra ,Islamic Work Ethics, *Al-Nahdah: Muslim News and Views* Vol 3, Issue 4 (October - December 1983).
- Ruzita Mohd. Amin and Selamah Abdullah Yusof.(2003) “Allocative Efficiency of Profit

Saqeq, A.H.M. (1989). Factor Pricing and Income Distribution. *Journal of Islamic Economics* 2.no 1 (January 1989). 45:57

The World Bank report, (2011) “Optimal Kesign for a Minimum Wage Policy in Malaysia” Human Development Department ,Social Protection and Labor ,Unit East Asia and Pacific Region(July 28, 2011)

Ximena Del Carpio, Ha Nguyen, Liang Choon Wang.(2012) “Does the Minimum Wage Affect Employment? Evidence from the Manufacturing Sector in Indonesia”TheWord Bank East Asia and the Pacific Region Social Protection Unit &DevelopmentResearch Group Macroeconomics and Growth Team July 2012 WPS6147 Public

Wakeford, J. (2004). The productivity–wage relationship in South Africa: an empirical investigation. *Development Southern Africa*, 21(1), 109-132.

www.ssig.gov.my