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BBVA Group
Research Department

Economic Observatory

Colombia

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Economic Analysis

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We expect a moderate real increase in the minimum wage

We estimate an increase in the minimum wage of around 5.5% (1.65% in real terms), affecting inflation, the labor market and public finances

Bearing in mind past increases and the method used for determining them, we expect an increase of 5.5% for 2012, with a confidence range of between 4.8% and 6.2%. The real increase would mainly boost prices of highly labor-intensive sectors, such as construction, textiles and apparel (8.6% of GDP in total). A rise contributes to the current inefficiency of the labor market, increases informality and limits the positive trend in job creation. In pubic finances, it increases expenditure on pensions (15% of the nation's budget) and public-sector workers (10% of the budget) by a relatively similar amount.

The well-known minimum wage debate

Discussions about the increase in the minimum wage began early this year. The trade unions and the Office of the Vice-President of the Republic had already suggested what they hoped for in 2012. Equally, the *Comisión de Concertación Laboral* (labor relations commission), the body that discusses the increase in the minimum wage, began its meetings in October by analyzing subjects relating to employment protection.

The discussion within the labor relations commission is well known. The Minister for Social Protection acts as mediator in the discussions between employers and workers, who have to agree the increase before the end of the year. If they do not do so, the government will fix the value, taking into account inflation, labor productivity, and GDP growth, remembering that since 1999 by constitutional mandate its increase cannot be under the inflation rate for the year ending.

The Governor of the Central Bank attends the meetings as observer, presents its forecasts for inflation and labor productivity, and suggests that the increase should be equivalent to the expected rate of inflation. The Director of National Planning also attends the meeting and explains the effect of the increase on employment, pensions and other public sector accounts, suggesting that the rise should be close to the inflation rate. The trade unions argue that a higher minimum wage stimulates consumption and is positive for the economy, while the employers' associations argue that an excessive increase could lead to a slowdown in output, generate unemployment and endanger the economy in an environment of international turbulence.

The mechanism to determine the increase provides clear clues as to its direction

Behind the well-known discussion, the mechanism for defining the minimum wage provides clear clues as to the direction the increase will take. Although the workers and employers take center stage and have to agree its value, both players know that if they do not reach agreement, the government will decide it by decree. In turn, the government has its own incentives (beyond the effects on the labor market). It knows that each percentage point increase in the minimum wage increases by a similar amount the monthly payments it must make on pensions, which in 2012 were close to 3.7% of GDP (15% of the budget); it knows that excessive increases affect the payment of wages to public-sector workers (10% of the budget); although it also knows that an excessively low minimum wage that is far removed from what the workers want may result in protests and demonstrations that undermine the government's popularity.

The employers and workers know the consequences of not agreeing an increase. Both know that the government will set a low minimum wage, close to what the employers want. Thus the employers have an incentive for not coming to an agreement with the workers (or if they do so, for agreeing a lower value than what they expect would be set by the government); the workers know that it will be difficult to agree with the employers, so they rely on social pressure (e.g. demonstrations and strikes) and propose an increase that they know in advance cannot be accepted by the employers, but that may influence the amount to be determined by the government.

This theoretical outline corresponds to the results of past discussions. Since 1999, eight of the twelve increases have been fixed by the government. The last time that the increase was agreed was in 2005. Moreover, the increase has systematically been closer to the value initially called for by the employers rather than the workers, both in years in which it was subsequently agreed and when it was fixed by the government. In fact, it has been 1% higher than the initial offer by the employers, but 4.1% lower than that of the workers.

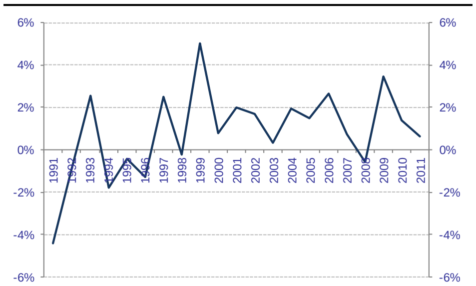
Table 1
Increase in the minimum wage: proposals by the workers and employers, and the final minimum wage

Year of increase	Workers' proposal	Employers' proposal	Increase	Decision
1999	15.0%	10.0%	10.1%	Government decision
2000	11.3%	9.4%	10.0%	Agreed
2001	9.5%	6.0%	8.0%	Government decision
2002	12.0%	6.5%	7.4%	Agreed
2003	10.0%	6.2%	7.8%	Agreed
2004	11.0%	6.0%	6.6%	Government decision
2005	10.0%	5.7%	6.9%	Agreed
2006	10.0%	5.0%	6.3%	Government decision
2007	11.0%	5.6%	6.4%	Government decision
2008	14.0%	6.5%	7.7%	Government decision
2009	8.0%	3.2%	3.6%	Government decision
2010	12.0%	3.0%	4.0%	Government decision

Source: Minprotección and BBVA Research
The source of the mechanism is Hernández (2007) and BBVA Research

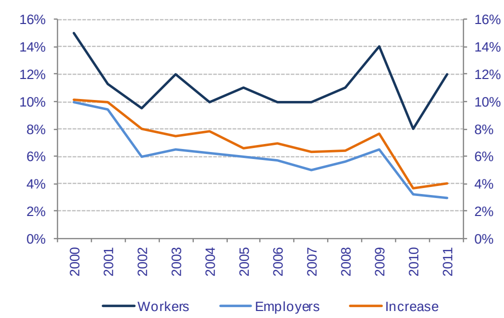
The real increase in the minimum wage has been 1.65%, adjusted for the average inflation for the year in which the increase was in force, with undetected (or insignificant) correlations with output, inflation, labor productivity or political leaning of the then government who mediated in the increase.

Chart 1
Real increase in the minimum wage: 1991-2011



Source: Minprotección and BBVA Research

Chart 2
Proposals for the increase in the minimum wage: employers, workers, and the actual increase



Source: Hernández (2007), Minprotección and BBVA Research

If this past history continues, the minimum wage in 2012 will increase by around 5.5%

Bearing in mind that the real increase in the minimum wage since 1999 (the year in which the Constitutional Court ruled that the increase must be greater than the inflation for the year ending) has been 1.65%, and taking into account BBVA Research's average inflation forecasts for 2012, we can expect the increase to be 5.5%, with a confidence range of between 6.2% and 4.8%.

The increase is positive in real terms, so Colombia will continue to stand out in the region for having a high minimum wage, equivalent to 50% of the average labor productivity. This contributes informality, unemployment and the low coverage of the pension system. These effects are well-known and there appears to be a consensus about them among economists, but there appear to be few political answers to them.