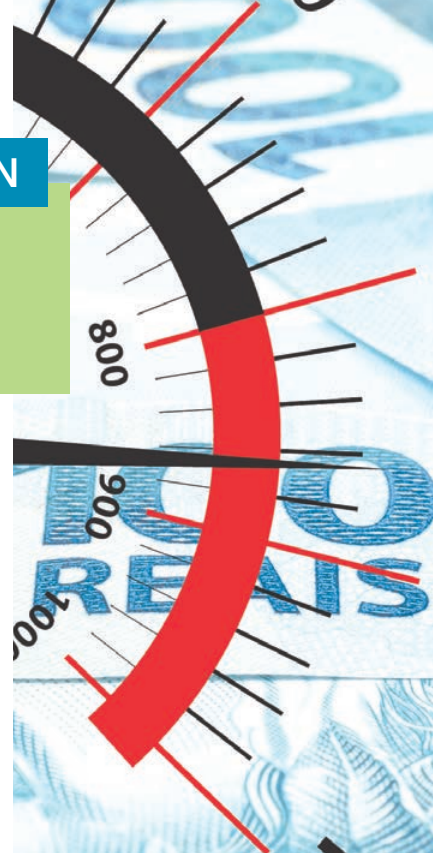
INFLATION

The minimum wage pressure



Solange Monteiro

SLOW PRODUCTIVITY GROWTH not only compromises competitiveness, it also fuels inflation as wage increases outpace productivity growth. In the past eight years, the minimum wage rose on average 5.4% a year above inflation and average salary 3.4% a year, but labor productivity grew just over 1% a year. "When productivity growth is high, wage increases do not increase costs; when it is low, however, wage increases are likely to reduce employment and profit margins or increase prices," explains Silvia Matos, researcher, Brazilian Institute of Economics (IBRE). Meanwhile, as the Central Bank points out, wage inflation can spill over into other sectors of the economy and amplify inflation.

Impact

The service sector, which represents 35% of the consumer price index, is labor-intensive, less exposed to international competition, and therefore more easily able to pass on its costs to prices. "Since 2003, the prices of several items that have considerable weight in the services price index have been rising along with the minimum wage," says Ricardo Summa of the Institute of Economics of the Federal University of Rio de Janeiro (UFRJ). Mario Mesquita, a partner in Brasil Plural Investment Bank, explains, "The cost of services is basically determined by labor and rent, and today service inflation is about 9% a year. The policy of setting the minimum wage contributes to inflation in services." Matos estimates that the contribution of the minimum wage to services inflation was about 0.8% a year from 2008 to 2012.

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>
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One of the main difficulties in defining how much the minimum wage affects inflation is the presence of another factor pushing wages up: low unemployment. Mesquita thinks that "Growth in wages has more to do with a tight labor market than with the policy of adjusting the minimum wage." A tight labor market gives workers more bargaining power in negotiating wage adjustments; a slack labor market would reduce demand for wage adjustments. Given the tight labor market, he says, "Any shock, any additional boost on prices tends to generate inflation. I think there is no way to reduce inflationary pressures in the economy without the labor market cooling off."

The resilience of employment despite the lack of dynamism in the economy makes it very difficult to predict

when the labor market might cool off. "We have already seen a slowdown in job creation and some moderation in wage gains," points out Braulio Borges, an economist at LCA consultancy. He notes that last year the average salary increased just 1.25% above inflation, the lowest in the last three years, according to the Unions Department of Statistics and Socioeconomic Studies. "Unionized workers are those that have greater bargaining power, yet their wages have not increased excessively," he says. Borges points out that there has been a significant change in the labor supply because of slowing growth of the working age population—estimated at 1.2% annually for 2001–20 compared to 2.3% for 1980–2000—and young people do not seem interested in looking for jobs, a trend Borges thinks needs more study.

Alternatives

UFRJ's Summa argues that policies to curb inflation should not be based on reducing wages, and the current formula for adjusting the minimum wage should be retained. Borges and Matos believe the best alternative would be to formulate a new adjustment rule based on productivity gains, although they recognize that the lack of information about hours worked today makes it difficult to calculate productivity. "The important point is that we cannot give increases in the minimum wage that will generate more inflation than benefits," Matos says. Mesquita thinks it is time to eliminate a formal rule for raising the minimum wage: "The minimum should again be a decision of the president. The current rule was created to discipline minimum wage increases but has ended up establishing a floor for raising the minimum wage rather than a ceiling."

Whatever the outcome of the review of the minimum wage adjustment rule in 2015, however, all experts advocate giving more attention to raising productivity. "Among other things, a more open economy, more exposed to international competition would help to raise labor productivity, but in recent years Brazil has moved in the opposite direction," Mesquita says. "For example, the automotive industry, which has traditionally been very protected, has more protection today than it had in 2010."

Matos underscores his point: "We need to give incentives for adopting new technologies and improving efficiency, especially in the services sector. Industry is forced to do so when there is international competition, but it is also important for Brazil to encourage this practice."

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