

## The doubling of the minimum wage: Impact on employment?

Following an unexpected government decision in October 2016, the minimum wage was doubled in January 2017 to UAH 3,200 per month (approx. EUR 110). As the new minimum wage covers 42% of employees, negative effects on employment are expected by many observers, especially in certain sectors and regions. According to the limited data that is available, our analysis does not suggest an immediate effect on employment so far. However, several aspects indicate that such an effect might realise later on.

### Background

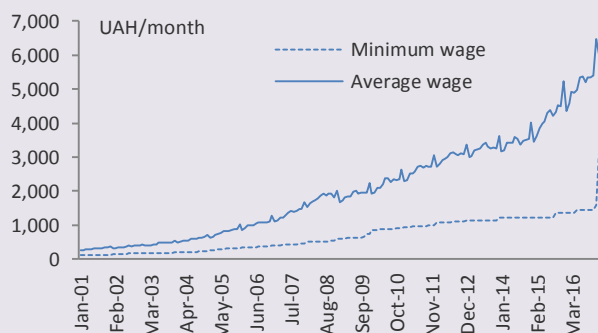
In October 2016, in the midst of the budget process, the government surprised observers by announcing an official minimum wage of UAH 3,200 per month (approx. EUR 110), effective from early 2017 onwards. This doubled the minimum wage from the previously planned level of UAH 1,600 per month from January 2017, and is up from UAH 1,450 in October 2016.

This decision, which was implemented shortly after it was announced, created significant challenges for the private but also the public sector, as a significant number of employees received salaries below the new minimum wage level. Additionally, the overall wage grid was linked to the minimum wage in the public sector. This newsletter reviews some preliminary findings, with a special focus on the effects on employment.

### Minimum wage in Ukraine and abroad

The following chart shows the development of the official minimum wage as well as the average gross wage in Ukraine since 2001 (in UAH per month). The recent hike stands clearly out in a historical perspective; usually, increases were enacted in a gradual fashion. This significant hike was also mirrored in average wages, which jumped in early 2017 as well.

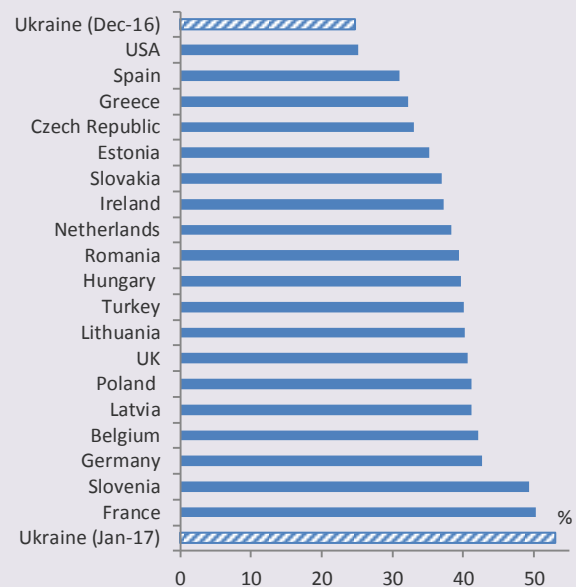
#### Development of minimum and average wage



Source: Law on the Minimum Wage, Ukrstat

An important indicator for the overall economic relevance of the minimum wage is its relationship with the average wage earned in an economy. Right before the change, Ukraine's minimum wage was only about a quarter of the national average wage, placing it at the bottom of a list of OECD countries. The hike of the minimum wage in early 2017 completely reversed the picture. With a ratio of more than 50%, the country jumped to the top of the peer group.

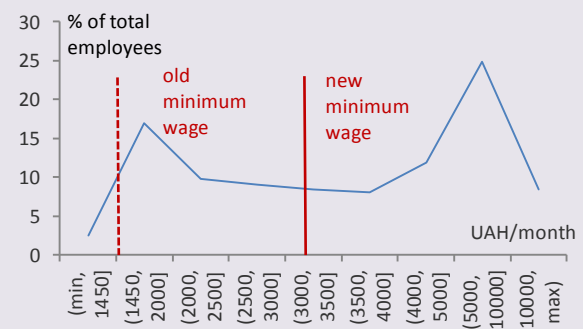
#### Minimum wage as % of average (mean) wage



Sources: OECD and Ukrstat; Note: 2015 for all OECD countries; Dec 16 / Jan 17 for Ukraine

Further interesting details are revealed when one looks at the distribution of monthly wages according to different wage brackets. While data are unfortunately not available for micro enterprises and employees of individual entrepreneurs, the data cover about 7.5 m employees.

#### Wage distribution, September 2016



Source: Ukrstat; data for December 2016 are available, but distorted due to bonus and other extra payments.

The bimodal wage distribution shows that almost 42% of all employees in the sample earned officially less than the new minimum wage i.e. were potentially affected by the change! If these employees' productivity has fallen below the minimum wage, employment might fall.

### Impact on Employment

In January 2017, employment indeed dropped by 1.4% as compared to December 2016, and the question is if this observation can be related to the doubling of the minimum wage in that month. We test the hypothesis of such a link in our preliminary analysis by exploiting the differences in the fraction of employees that earn up to the new minimum wage across regions and sectors of the economy. If the minimum wage hike had an effect on employment, this should have been more severe in regions and sectors with a higher share of employees that have earnings up to the new minimum wage. In terms of regions, Ternopil, Chernivtsi and Kherson stand out, while in the sectoral view the service sector is the most affected one.

If we correct for seasonal effects in employment, the results of our analysis suggest no such causal link. Thus, regional and sectoral employment changes do not correlate with the share of minimum wage receivers in those particular regions or sectors. The employment drop observed in the data cannot be explained by the minimum wage hike, but must have other reasons which are outside the scope of the analysis.

### Preliminary conclusions and caveats

Based on official data, the recent minimum wage hike did not cause a drop in employment in sectors and regions where minimum wage earners are widespread. However, this is still a very preliminary result, and the impact might be spread over time. Furthermore, as the public sector employs a significant number of minimum wage earners, political considerations might be also evident in the data.

Another caveat is the data situation, where many employees of small companies are simply not covered. It is reasonable to assume that especially those small companies are engaged in predominantly low-productivity activities and rather sensitive to changes in the minimum wage.

Furthermore, the large share of the informal economy (35% of GDP according to latest estimates by the Ministry of Economic Development and Trade) makes it difficult to assess the employment impact of this policy change. Proponents of the hike point out that a significant (but unknown) share of employees receives officially the minimum wage, but another part of their salary "in the envelope". This provides some cushion against employment changes, and might lead to an

increase in official earnings and tax and social security contributions. However, the opposite case is also conceivable, i.e. companies moving into the informal sector in response to wage costs that are now above productivity. A last point relates to the new shape of the wage distribution. As a larger fraction of employees now earns the minimum wage, differentiation in labour compensation is reduced. This can be expected to add upward pressure on wages for certain income groups, so that negative employment dynamics might result later on.

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Note: A more comprehensive analysis of the topic is provided by the Policy Briefing PB/05/2017 „Preliminary analysis of employment impact of the recent minimum wage hike“.

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### German Advisory Group

The German Advisory Group advises the Government of Ukraine on a wide range of economic policy issues since 1994. The group is financed by the German Federal Ministry for Economic Affairs and Energy.

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