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Reducing the race to the bottom: A primer on a global floor for minimum wages

José Caraballo Cueto^a

Abstract

A “race towards the bottom” in very poor countries is a policy that deliberately depresses wages to attain higher competitiveness in the global market. This policy distorts the comparative advantages that would emerge in the absence of such an economic policy and also induces lower purchasing power, leading to suboptimal consumption. There are barely any theoretical models (to our knowledge) showing the impact of a global minimum for minimum wages. We found that, under such circumstances, a global lower bound for minimum wages that re-establishes the competitive wage rate in very poor countries represents a Pareto improvement: It enhances the markets due to the expansion in sales caused by the increase in real wages of the vast majority (workers). One of the innovations of this primer is to apply a simple DSGE model to the macroeconomic consequences of a global minimum for minimum wages.

Keywords: Minimum wage; global labor standards; race to the bottom; multinationals; DSGE.

JEL Classification: F12; F55; F47; J8; J42; O17; O19.

Resumen

Una carrera hacia la depauperación en países muy pobres es una política pública que busca reducir deliberadamente los salarios para tratar de alcanzar una competitividad mayor en el mercado global. Esta política desvirtúa las ventajas comparativas que

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a Universidad de Puerto Rico (Puerto Rico). Correspondence: jose.caraballo8@upr.edu

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emergerían en ausencia de ese tipo de política económica y también induce hacia un poder adquisitivo menor, llevando a un consumo subóptimo. En la actualidad no se ha modelado teóricamente (hasta donde sabemos) el impacto de un mínimo global para los salarios mínimos. Bajo estas circunstancias, encontramos que una cota inferior global para salarios mínimos que restablezca el salario competitivo en estos países muy pobres representa una mejora paretiana: magnifica los mercados gracias a las nuevas ventas que ocurren gracias al aumento en el salario real de la mayoría (trabajadores). Una de nuestras innovaciones es introducir un modelo DSGE sencillo para modelar las consecuencias macroeconómicas de un mínimo global para los salarios mínimos; un tema poco estudiado en la literatura relacionada.

Palabras claves: salario mínimo; estándares laborales internacionales; carrera hacia la depauperación; multinacionales, DSGE.

Clasificación JEL: F12; F55; F47; J8; J42; O17; O19.

INTRODUCTION

Mexico, once considered a powerhouse for low-wage jobs, allegedly has lost more than 500 *maquiladoras* following the admission of China to the World Trade Organization (WTO) (Chan, 2003). China, on the other hand, has supposedly lost some ground in attracting multinational corporations due to the lower labor cost of Vietnam (Kahle, Boush, and Phelps, 2000). Olney (2010) and Davies and Vadlamannati (2013) also have found evidence of a race towards the bottom in labor standards. That is, many countries, from Mexico to China, allegedly feel more pressure to reduce their wages and other labor standards (and thus the standard of living of the vast majority) to attain some comparative advantage in attracting firms.

Since the economic policy of defying comparative advantage by depressing wages (*i.e.*, race towards the bottom) also induces a lower purchasing power, it represents a constraint for consumption, making the race towards the bottom a suboptimal scenario that lowers general welfare. We wonder if there is a Pareto improvement that addresses this suboptimality. We found that, under certain circumstances, setting a certain low global minimum for minimum wages that reduces the race towards the bottom can represent a Pareto improvement by reducing poverty, increasing purchasing power of poor (*i.e.*, low-income) countries, increasing demand in poor countries, and creating a non-negative change in profits through the new expansion of goods markets.

To model the effects of a global lower bound for minimum wages, the consequences for goods markets should also be considered. In fact, it is well-known

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