NEW STRAITS TIMES

Tuesday, October 28, 2014

Widening income gap shows aid must be targeted

By Dr Juita Mohamad

CLEAR DENIFITION: *With proper monitoring, policymakers can set up a lasting social security net*

IN his ground-breaking work, Schooling, Experience and Earnings, Jacob Mincer, also dubbed the father of modern labour economics, had highlighted two main factors that could determine wages: schooling and work experience. These factors are incorporated in his formula, the Mincer equation, and has been applied widely by labour economists.

The study of wages and its determinants has come a long way since the 1970s. Labour economists now use extensions of the basic Mincer equation to investigate other country-specific factors that may affect wages or, more precisely, real wages of workers in their country and demography.

In a recent study done analysing the determinants of wages in Malaysia from 1989-2009, education, occupation and industry factors were incorporated. In Malaysia, education alone cannot explain much the observed wage differences between workers. This is because even within the same level of education attainment, wage inequality can be observed among workers. This is true for all types of certificate holders: Penilaian Menengah Rendah, Sijil Pelajaran Malaysia, Sijil Tinggi Persekolahan Malaysia, diploma, degree and non-certificate holders.

What is worse, the wage gap between the 90th and 10th percentile of workers within the same level of education attainment has been increasing for all groups except for degree holders and non-certificate holders. The wage gap has drastically narrowed down for the two groups, especially since 1997. When the industry and occupation indicators were factored into the analysis, only a small fraction of wage differences can be explained by the industry the worker is affiliated to, and by the occupation the worker is involved in.

The next issue to look into is what other factors determine the wage gaps among local workers in Malaysia? If education, occupation and industry factors cannot explain much about the wage differences in Malaysia, what other factors should we look into? Wage inequality, to a certain degree, is inevitable and encouraged as it is seen as a source of motivation for investment in skills, knowledge and innovation. What is worrying though is when this wage inequality is glaringly large and unjustified.

As a multiracial society, demographic factors may affect the wages of workers in Peninsular and East Malaysia. Using 30 per cent of the Household Income Survey data collected over 20 years, the recent study incorporated related demographic variables that may affect real wages in the local context.

Over the period observed, the wage gap between male and female workers has significantly decreased, and this can be translated into higher motivation for women to participate in the workforce in the near future.

As for married and unmarried/single workers, the wage gap has increased drastically, especially since 1997. In 2009, married workers earned 21 per cent more than unmarried workers.

In terms of race, the wage gap between Bumiputera and Chinese workers has significantly increased by more than tenfold in the 20 years under study.

When we look at the location of workers, as of 2009, Kuala Lumpur inhabitants earn 35 per cent more than those living in East Malaysia. From this finding, it is not surprising to see that the wage gap between urban and rural inhabitants has been increasing drastically by threefold over 20 years.

With all the findings highlighted, what should come out of this?

With a clearer picture of those lagging behind, subsidies and other forms of help given by the government should be targeted to those in need.

An example of targeted monetary assistance could be channelling a bigger share of the one-off 1Malaysia People's Aid to rural inhabitants as they are seen to receive double-negative blows. The first blow would be the significantly lower wages earned, and the second blow would be the drastic widening of the wage gap between the two groups of dwellers.

With focused targeting comes greater incentive for monitoring. As the scope of recipients are clearly outlined and determined, the task of monitoring, then, becomes relatively easier.

With monitoring, policymakers can replace the existing temporary assistance with a permanent and effective social safety net scheme (which is part and parcel of a high-income and developed country). This way, unjustified wage inequality among temporarily disadvantaged workers can be dealt with in the short run without it spiralling out of control in the long run.

Dr Juita Mohamad is Senior Analyst (Economics Division) at the Institute of Strategic & International Studies (ISIS) Malaysia