The Living Wage approach in agriculture:

An Introduction

Discussion paper

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Summary

This paper explores how the concept 'Living Wage' that is used in industry, can be applied in agriculture as well. Use of this concept may be useful to arrive at a calculation of 'fair' prices the agricultural producer should receive for his products.

Based on existing Living Wage definitions, an example is provided how the Living Wage has been calculated in India. Ideas are developed how to combine Living Wage and production costs in agriculture. The result is a combination of both an ethical approach and market prices that result from supply and demand. Use of the Living Wage concept in agriculture and rural development may result in a better understanding and more problem-oriented solutions at policy level.

Preface

This version is different from the previous (November 2012) version in two important ways.

The first is that the equations in the chapter "***Combining Living Wage and production costs"*** have been expanded thanks to critical comments of Prof. Sukhpal Singh on the previous version.

The second is that in the chapter "***Living Wage"*** an example is added of a way how the Living Wage has been calculated in the case of India.

Introduction

In an article in 'Development in Practice' about local purchase for food aid that appeared it is argued that World Food Programme (WFP) should pay a higher price for food than the market price to marginal producers (Bronkhorst 2011). This leads to the question what price to pay to the producer. This question is not only relevant for local purchase by WFP, but has a larger impact. This discussion paper aims at providing a first approach to the development of a model how to calculate such prices.

The importance of agriculture for the world cannot be overstretched. Without good and efficient agricultural systems the globe cannot provide sufficient food for its inhabitants. Not only farmers live of the land, all other people depend on it as well. Therefore it is very important that the sector is organized in such a way as to benefit as many people as possible. Not only a high food production is needed, also as many people as possible should reap the profits of this production. Much of the produce is lost because of problems with storage and transport. A lot of attention is given to these issues nowadays, which is a good development. Although the concept of micro-finance is now widely accepted, still always too little attention is given to the financial problems of marginal farmers that prevent them from investing in better agricultural techniques, including storage. When a farmer does not earn enough by the sale of his produce to sustain himself, his family and his workers, he cannot be expected to put money aside to invest. Therefore it is very important that the farmer gets a sufficient price for his products so that he will be able not only to sustain himself, his family and his workers, but will also have funds to invest in improved techniques to raise and store his production. In this sense the payment of a 'fair' price to the producer is a matter of interest to the whole sector.

An approach to determine the necessary minimum income workers should receive that is quite some consensus about, is the concept of a Living Wage (LW). In this paper I will first examine the Living Wage approach as it has been developed for use in industry. This approach, combined with production costs, is often the starting point for the calculation of a 'fair price' in industry.

In the agricultural sector combining the concepts Living Wage and production costs leads to specific sector-related problems. Prices are usually defined by the equilibrium point of supply and demand. However, market distortions often result in prices different from what the equilibrium price in perfect competition would be.

After a short discussion of production costs, the topic how to combine Living Wages and production costs will be analysed. Based on this analysis minimum prices can be calculated that may be different from market prices. After some further remarks about the differences between Living Wage prices and market prices, conclusions will be drawn.

Living Wage

In order to determine what the minimum amount is workers should receive in order to sustain themselves as well as their family, the concept of a Living Wage (LW) has been developed. There are several definitions of 'Living Wage' that mainly differ on details. Some of these definitions are:

SA8000:"A "living wage" means one that enables workers, for their labor during a standard workweek, to support half the basic needs of an average-sized family, based on local prices near the workplace" and "A company shall pay a living wage for a standard work week (i.e., no more than 48 hours per week or less if set at a lower level by national law) and workers shall earn that sum without working overtime. Basic needs include essential expenses such as food, clean water, clothes, shelter, transport, education and a discretionary income, as well as the workers' costs for legally required social benefits (e.g. health care, medical insurance, unemployment insurance, retirement plan, etc.)" (SA8000).

In The *Ethical Trading Initiative (ETI) 1998 Living wage formula* a living wage is to be earned over a maximum working week of 48 hours and basic needs are defined as housing, energy, nutrition, clothing, health care, education, potable water, childcare, transportation and savings, though the possibility of including further need categories (e.g. entertainment, vacation, paid family leave, retirement, life insurance and personal liability insurance) is floated (Steele).

From the ETI Base code: Wages and benefits paid for a standard working week meet, at a minimum, national legal standards or industry benchmark standards, whichever is higher. In any event wages should always be enough to meet basic needs and to provide some discretionary income. (ETI Base code)

ILO has included living wage as a human right in several major Declarations (Anker).

ILO considers two factors very important, namely a. that the level of a minimum wage should be set high enough to be considered as decent, and b. that social partners should be involved in decision-making. This implies a negotiations approach with a decent wage as minimum (ILO).

So in all these three approaches of ETI, SA8000 and ILO a minimum income is fixed.

It should be realized that 'Living' Wages may be different from national legal minimum wages. These minimum wages often are the result of political negotiations in which the interests of the workers may be subjected to other interests that may be considered to be more in the national interest.

in order to calculate a Living Wage two main formulas are used, namely the 1998 Living Wage Summit formula and the SA8000 formula. To be able to use either of these formulas a large quantity of data about basic needs has to be assembled. Basic needs include essential expenses such as food, clean water, clothes, shelter, transport, education and a discretionary income. It is evident that the collection of these data requires a lot of time, knowledge and effort.

In order to solve this problem, some organizations have found a short-cut. Examples of this are ILO, CREA and World of Good that are using PPPs (Purchasing Power Parity in US$). The PPP$ rate is the number of units of domestic currency that are necessary to obtain a purchasing power that is

equivalent to $1 in the United States. Wage rates are converted to $ US in terms of purchasing power (ILO, CREA, World of Good).

The advantage of the PPPs method is that it allows for a rapid comparison of income worldwide. The disadvantage is that PPPs come available only years later and that it does not take into account regional and country specific differences (e.g. in food habits). For that reason in this paper preference is given to the ETI and SA8000 approaches, because they try to represent the actual situation closest.

The 1998 ETI Living Wage Summit formula

This formula calculates the living wage from the cost of basic needs per person, multiplied by average household size, then divided by the average number of earners per household, with an allowance for savings added on (Steele):

$$\frac{\textit{Average household size } \textbf{x} \textit{ cost of basic needs per person}}{\textit{Average number of adult earners per household}} + \textit{ savings (set at 10\% of income)}$$

The SA8000 formula

The SA8000 formula is a variant on the 1998 ETI Living Wage Summit formula. It splits the basic needs measure into two components, a measure of food costs per person, multiplied by the ratio of average total household expenditure to average household food expenditure in the country in question. It also makes the assumption of two earners per household by multiplying by half the average household size, rather than combining the two averages (household size and number of adult earners) (SA8000):

[Basic food basket x (1 / % of avg. household expenditure spent on food) x (0.5 x avg. household size) x 1.1]

In both these two formulas there is reference to household size and adult earners per household. Since in not every country the household size is dominant but all other forms of living and sharing together exist, the term 'household' could be interpreted in a wider sense so as to imply where needed, extended families as well.

It could be considered unreasonable that in regions where families have many children the Living wage is higher than in regions where families are smaller, but it should be kept in mind that, apart from the fact that more people must be fed, children often are a protection for old age by absence of retirement provisions. So better retirement provisions will ultimately lead to fewer children as well.

These formulas do not take into account provisions provided by the employer, such as free housing, medical insurance, retirement schemes etc. These provisions should be calculated though and may be deducted from the calculated Living Wage of the workers involved.

The SA8000 formula uses a relationship food : non-food costs (extrapolated market approach). This is possible but attention should be paid to the fact that this relationship will be different from one

place and group to another, so when applied it should be with great care that a correct relationship is taken.

To determine the food basket different approaches use different calculations for the kcal/day, ranging from 2100 to 3000 kcal/day. The World Health Organization (WHO) has developed guidelines that the average calorie supply of workers in the least developed countries that is needed to perform a full day of medium-heavy work is 2400/kcal/day. For heavy physical work this can be raised (see a list prepared by FAO for energy costs of activities (FAO).

So another possibility is to combine both formulas to the following formula:

$$\frac{\textit{Average household size x (cost of food + cost of non-food per person)}}{\textit{Average number of adult earners per household}} + \textit{ savings (set at 10\% of income)}$$

Whereby:

- The local average household size (which can be different from a standard family) and the average number of adult earners per household are used
- Where the non-food component cannot easily be determined, the extrapolated approach with percentages adapted to local circumstances can be used
- For the food component a norm of 2400 kcal/day could be used
- The sum of the weights of its members is calculated by valuing adults as 1, and persons aged under 18 as 0.5.
- Deduct all provisions provided

It should be noted that it is not always necessary to make an extensive research to obtain the necessary data. Often many data are available. There are a number of possible sources to obtain the necessary data. These are first the national governments, universities and research institutes, but also different organizations of the United Nations (FAO, UNICEF, UNDP, WFP etc) and the World Bank can provide much information. Then there are Embassies who because of their role in the monitoring and execution of development projects are in the possession of much information as well.

To give a concrete example: In India Government data concerning the poverty line and average household size have been used to calculate a 'living wage' according to the 1998 Living Wage summit formula in the following way (Bronkhorst 2004)[1]:

The poverty line per capita in India as defined by the Planning Commission is based on the number of calories needed daily per person. This quantity has been defined in 1968 by a Nutrition Expert Group and has been fixed at 2400 calories per capita in rural areas and 2100

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[1] The following is a summary of the article "'Fair' Prices and Wages", published in Economic and Political Weekly. For the full text see the article.

calories per capita in urban areas. The difference in quantities of food needed in rural and in urban areas is due to the fact that living conditions in rural areas are more demanding. For instance rural people often have to walk great distances to have access to water.

The quantification of the number of calories needed was after research translated into monetary units to answer the question: How much money is spent on average to achieve the necessary quantity of calories? Data for this came from an expenditure survey at the group involved. From this survey it appeared that, based on the actual consumer behavior, in 1973-74 on an average Rs 49.09 a month was associated with a daily intake of 2400 calories in rural areas, and Rs 56.64 per month with a daily intake of 2100 calories per capita in urban areas (Govt of India Planning Cie, Govt of India 2002).

So the poverty line defined this way is partly normative and partly behavioral. It indicates the monetary value needed to achieve the specific quantity of calories needed, taking into account the need for other, non-food related, expenses.

These amounts needed are adjusted regularly through follow-up investigations recurring at set periods.

Different amounts for the poverty line for different states have been calculated at an official level. This is because India is such a large country with so many regional differences.

Table I *State wise Poverty lines for the year 1999-2000 in Rs per capita per month*

State/Union Territory	Rural Poverty line	Urban Poverty line
Rajasthan	344.03	465.92
Delhi	362.68	505.45
Pondicherry	307.64	475.60

Source: Planning Commission, Government of India

The poverty line indicates an amount per month per capita. Not everyone within a household earns income, however. The following table indicates average size of households in Rajasthan, Delhi and Pondicherry.

Table II *Average Household Size by State/Union Territory 1999-2000*

State/Union Territory	Rural	Urban
Rajasthan	5.6	5.0

Delhi	4.4	4.4
Pondicherry	4.2	4.0

Source: Manpower Profile India, Yearbook 2001 table 1.17

The poverty line per household is obtained by multiplying the poverty line by average household size.

Table III *Poverty line in Rs per month per household by State/Union Territory*

State/Union Territory	Rural	Urban
Rajasthan	1927	2330
Delhi	1596	2224
Pondicherry	1292	1902

The 'average number of adult earners per household' is more difficult to obtain. Although many married women do have a paid job, this certainly does not apply to all of them. For cultural reasons, many women are not allowed to work outside the home. Where women, both married and single, are allowed to work outside the home, it often is only in places where the working place is considered 'safe' for them. The 'Labour Force Participation Rate' gives the following picture:

Table IV *Labour Force Participation Rates by State/Union Territory, 1999-2000*

State/Union Territory	Rural		Urban	
	Male	Female	Male	Female
Rajasthan	50.3	38.8	49.9	14.1
Delhi	54.1	3.7	54.6	10.9
Pondicherry	58.8	29.4	57.4	18.1

Source: Institute of Applied Manpower Research, Manpower Profile India, Yearbook 2001, table 2.2.2

Like all data, these should be carefully used. There is always the danger of drawing too many conclusions from data that cannot entirely be relied upon. What these data do indicate, however, is that many more men than women have a paid job.

What can be concluded from these figures though, is that we cannot take for granted the fact that both man and wife have a paid job. This has its consequences for the calculation of the living wage.

The outcome will be different when we make the calculation with one, or with two income earners per household.

On basis of this it seems in this case not correct to make the calculation of a 'living wage' on the basis of two income earners per household. It seems preferable to calculate it on the basis of one or one and a half income earner per household.

 This leads to the following quantification concerning the 'living wage'.

In case of one income earner per household

Table V *Amount of the Living Wage per month in Rs by State/Union Territory in case of*

one income earner per household

Amount Living Wage (Rs)

State/Union Territory	Rural	Urban
Rajasthan	2141	2588
Delhi	1773	2471
Pondicherry	1436	2114

In case of 1½ income earner per household

Table VI *Amount of the Living Wage per month in Rs by State/Union Territory in case of*

1½ income earner per household

Amount Living Wage (Rs)

State/Union Territory	Rural	Urban
Rajasthan	1427	1726
Delhi	1182	1647
Pondicherry	957	1409

Production costs

In order to be able to pay a Living Wage to wage-workers as well as to family members, the revenue of the farm must be calculated. In the case of a large farm with agricultural labourers that work all year, revenues of the farm must be sufficient to pay the wages. In the case of part-time workers and family members / owners who do other jobs during the year as well, the revenue should be sufficient to pay the Living Wage for the hours they work for the farm.

Therefore we first have to look at the income generated at the farm. That means first of all revenue minus production and storage and marketing costs. This is calculated at actual market prices. At what price does the producer sell and how many costs has he made for his production?

A balance-sheet in FCFA[2] per ha. for a farmer producing sorghum in Burkina Faso gives the following picture (Bronkhorst 2006)

Table VII

Sorghum	Revenues in FCFA		Costs in FCFA
Improved variety[3]	170.000	Total costs a. with tractor	126.250
Local variety[4]	120.000	b. with plough	93.750
		Profit per ha.	
		a. i. tractor and improved variety	43.750
		ii. tractor and local variety	-6.250
		b. i. plough and improved variety	76.250
		ii. plough and local variety	26.250

On land cultivated with sorghum normally no fertiliser is applied

The break-even points are a sales price of:
a. i. tractor and improved variety   74 F/kg
   ii. tractor and local variety   105 F/kg
b. i. plough and improved variety   55 F/kg
   ii. plough and local variety   78 F/kg

These break-even points are the sales prices at which the producer only covers his costs, with no net earnings at all.

The above is a static model for one ha and therefore it cannot be excluded that economies of scale when working a larger area will make use of the tractor more profitable.

If we calculate the same way the break-even prices for his other products, the total is the total amount the farmer would need to receive to cover his costs only.

A comparison of these prices with the prices needed to achieve a Living Wage shows the gap that has to be covered.

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[2] 1 € = 655 FCFA
[3] 1700 kg/ha * 100 F
[4] 1200 kg/ha * 100 F

Combining Living Wage and production costs

The question at hand now is how much money the farm should generate to be able to arrive at Living Wages. This implies calculations as to what product should be produced with given production methods at this type of land in this climate to optimise revenues. Revenues not only depend on physical produce, but also on market prices. Quantity produced * price per unit – production costs - marketing and storage costs = revenue. Here it is mentioned quantity and not quantity sold only because auto-consumption has to be taken into consideration as well.

Let us take a simple example of a plot of land of 1 ha, with only one crop, say millet.

Equation I

The revenues are: $X = (a-y) - s$

Where:

X = total revenue

a = revenue at market price for millet

y = production costs millet

s = marketing and storage costs

Production costs includes depreciation costs on investments.

In order to be able to earn a Living Wage, the following must be true:

$LW \geq X$

$X = (a-y) – s$ is a real equation in the sense that it is always true. X changes according to changes in the other parameters.

$LW \geq X$

 is something different. Here a subjective element is introduced and $LW \geq X$

 is not necessarily always the case. LW may be higher or lower than X. X is a certain amount and may be, or may be not, equal to LW.

This implies that 1 ha with this market price should be enough to earn a LW. Should he have 2 ha. though, the market price may be different.

This means that we will have to adjust the equation in order to take into account the size of the farm.

Equation II

$X=\{(a*b*c)-(y*c)\} – (s*c)$

Where:

X = total revenue

a = Market price for millet per ha

b = production of millet per ha

c = size of the farm in ha

y = production costs millet per ha

s = marketing and storage costs per ha

What should be included in the equation as well is return on investment. A producer should have a decent return on his investments as well.

This means the equation will be expanded to:

Equation III

$X = \{(a*b*c)-(y*c)\} - (s*c) - r$

Where r stands for return on investment.

Let's now consider the same example of a plot of land of 1 ha, now with two crops, say millet and sorghum. Revenues will be:

Equation IV

$X = \{(a*b*e) - (y*e) + (d*f*g) - (z*g)\} - \{(s * (e+g)\} - r$

Where:

X = total revenue

a = Market price for millet per ha

b = production of millet per ha

e = part of the farm in ha used to produce millet

y = production costs millet per ha

s = marketing and storage costs per ha

r = return on investment.

d = market price sorghum

f = production of sorghum per ha

g = part of the farm in ha used to produce sorghum

z = production costs sorghum per ha

This means that, with a fixed amount of land and given production methods, in order to arrive at a total revenue that equals the Living Wage, either prices must attain a certain level or other products should be produced of which market prices are higher. In the long run production methods that lead to higher yields may be introduced, but to do so the farmer first needs funds to be able to invest.

This is the case when the producer works alone. In that case we can say that the residue should be at least equal to the Living Wage. But what if others are employed as well?

When there is question of hired labour, these costs are to be included in the production costs as actual expenses made by the employer. When, apart from net wages paid to the labourer, amounts have to be paid to pension funds, taxes etc., these should be included as well.

In the case of own or family labour though, things are different because no amount is paid as wage but the farmer has to wait for the revenue of his produce to see what he has effectively earned. For his family members a salary should be calculated for their working hours that is equal to the wages per hour paid to hired labour (which in all cases should be corresponding with Living Wages for daily work during the whole year).

In reality marginal farmers live not only of their crops, but do have alternative sources of income as well (working as a day labourer etc). The equation then becomes

Equation V

$X = \{(a*b*e) - (y*e) + (d*f*g) - (z*g)\} - \{(s * (e+g)\} - r + (q-h)$

Where:

q = income from other sources

h = expenditure made to obtain this additional income

Decisions about what crops to grow in a certain year are routine considerations for farmers who have a choice between different crops. It is more complicated for those farmers who, because of climatic conditions and structure of the soil, do not have a choice between different crops. An example of this are farmers in Sahelian countries who have the choice between millet and sorghum and, if they are lucky, maize as well. With at the end of the growing season their production fixed, they completely depend on the price they receive for their products. Now these market prices are under strong pressure from food imports, be it the same type of food or a substitute. So the crops mentioned before, millet and sorghum, can be replaced by rice which is easier to prepare. The urban population, when given the choice between rice and millet or sorghum for equal prices, will make the choice for rice. This is what happens in Sahelian countries and that is not because the local rice is competitive, but because rice is imported be it in the form of food aid or at subsidised prices. From a political point of view this is quite understandable: there is nothing that authorities fear as much as riots in the cities because of high food prices. But for the farmers this subsidized food means that market prices for their products are lower than would be the case when no food were imported.

We have started this paper with an overview of the two most common ways how to calculate Living Wages followed by a third, an adapted Living Wage formula. Now whichever formula is used, the outcome of those calculations must be compared with production costs. Using the equations above it is possible to calculate a price for the products for which the producer will be able to generate enough revenue for a Living Wage. This is not simple because the different prices must lead to a total revenue that has to be equal or more than the calculated Living Wage.

Living Wage prices and market prices

When the market is such, be it due to food aid, subsidized food imports or other factors, that it is impossible for the producer to earn a Living Wage at actual market prices, interventions may be needed. As shown above Living Wage prices are calculated prices that involve certain ethics, namely that people should earn enough by their work to live on. These prices are not artificial prices though, like shadow prices, but calculated on basis of market prices.

Market prices are determined in a way that is completely different from the way in which Living Wage prices are calculated. Market prices are usually determined by offer and demand. In conditions of perfect competition this will result in an equilibrium price. It is well known though that there are many market distortions (power positions of market parties, in- and export interests, other government policies) that make that many market prices do not reflect equilibrium prices. In order to make a good comparison first should be analysed what the theoretical market prices of the different products would be in case of perfect competition. Only when subsidised imports and monopoly and monopsony positions on the markets are excluded, real prices can be compared. When these market distortions are not repaired, other measures could be considered like ending regular food aid and subsidized imports, to giving a premium to farmers, the same way as is common in western countries.

Instead of higher producer prices or premiums, it is also possible to raise the level of income by the creation of alternative employment in the rural areas. After all, the Living Wage is calculated not only on the basis of agricultural sales, but on other income as well.

There is always a limit to the prices, namely the willingness of the consumers to pay. If Living Wage prices for the products appear to be too high even when there are no market distortions, there will be no demand and it will be better for the producer to look for other ways to earn a living.

Planners as well should ask themselves how to continue at that point. At a certain point it must be concluded that this way it is impossible to earn a Living Wage so alternatives should be looked for.

Conclusions

To solve the problem of too low agricultural income to be able to invest, it is important that the farmer gets sufficient revenue from his work to be able to:

(a) pay all costs, both fixed and variable costs;
(b) earn a Living Wage;
(c) guarantee continuity of the enterprise;
(d) be able to pay a Living Wage to all workers employed;
(e) make the necessary investments (seed, equipment etc).

To find out whether this is feasible, the next steps have to be taken

- Calculation of Living Wages
- Calculation of production costs
- Calculation of prices needed to achieve Living Wages
- Calculation of differences of Living Wage prices with actual market prices

Knowledge of these items will enable planners and governments to take those measures that are needed to formulate policies to ensure Living Wages to its rural population either by higher producer prices or by alternative measures to ensure at least Living Wages for its population.

For farmers, esp. small-scale and marginal farmers, it is important that they have sufficient income to cover all their essential expenses, as well as a surplus that enables them to invest in seeds and equipment. So the Living Wage should be seen as the essential minimum a farmer should earn and this amount should be raised by a premium to enable him to make essential investments.

Also for full-time agricultural workers it is important that the differences between market prices and prices needed to achieve Living Wages are covered, so that employers are capable of paying a decent wage to their workers. This in order to give rural people a chance to live and develop. A way to do so is by removing market distortions (such as subsidized food imports, food aid that is sold on the market, power positions in the marketing chain) that have a negative effect on market prices of agricultural products as well as by providing infrastructure, giving income- or production subsidies or by creating more remunerative employment in the rural areas.

The decisions taken at policy level will depend on the political will and the importance attached to the development of the rural sector.

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