Effects of doubling workers wages on consumer price

For teaching purposes

An interesting criticism on the payment of living wages to producers, is that it leads to higher consumer prices. Consumers would be unwilling to pay these higher prices, so it is impossible to pay higher wages.
Now it is clear that in those cases where little transport and intermediate trade are involved, a rise in wages will lead to a corresponding rise in consumer prices. In practice however, there are many other costs involved before the product ends with the consumer.
The rise in costs is often calculated by percentages. Each new intermediary adds a certain percentage on the cost price thus far, e.g. 15, 20 or 30%.
In the attached example this leads from a total of initial production costs of let's say 50 €, of which 20 € labour costs, to a consumer price of 143 €.
A doubling of wages from 20 € to 40 € would lead to production costs of 70 €, and ultimately to a consumer price of 201 €, which is indeed quite a difference with 143 €. A rise in consumer price with 58 € will indeed usually lead to less byers, if the product is not essential.

Should the new consumer price be calculated by taking the same margins for intermediaries as they used to have in money, instead of percentages, the effects of the wage increase will be more limited. In the example the profit of the importer is an amount of 17 €, or 20%. If wages are doubled from 20 to 40 €, his profit will rise from 17 to 23 €. This rise in profit takes place without any more work or costs for him involved. If however, he would be satisfied with the same profit as before, namely 17 € and all others in the chain will do the same, the result will be a consumer price of 168 € instead of 201 €. This means that the direct effects of the wage raise are limited to the amount of the wage increase (20 €) plus more taxes (18 € instead of 13 € because these are always expressed in a certain percentage).

A lesson that can be drawn from this simple example is that attention should be paid to the other actors in the chain as well, such as importers and retailers. More attention to the chain when discussing possibilities of raising wages to at least Living wages will thus create more possibilities for improvement of workers incomes.

Below is a very simplified model showing the differences in consumer price when calculations are made with fixed amounts instead of percentages. Please note that this model is merely a model to show how different ways of calculation can have different results.

	Initial wages of 20 €		Doubling of wages,		Doubling of wages,
			other cost increases		other costs
			in %		in fixed amounts
Description	€	%	€	%	€
Labour	20		40		40
Material	20		20		20
Rent	5		5		5
Other costs	5		5		5
Total production costs	50		70		70
Profit	5	10%	7	10%	5
Subtotal	55		77		75
Transport	8	15%	12	15%	8
Subtotal	63		89		83
Shipping and Handling	13	20%	18	20%	13
Subtotal	76		106		96
Transport and handling costs	4	5%	5	5%	4
country of destination					
Storage	4	5%	5	5%	4
Subtotal	83		117		103
Profit importer	17	20%	23	20%	17
Subtotal	100		140		120
Costs and profit retailer	30	30%	42	30%	30
Subtotal	130		182		150
Taxes 10%	13	10%	18	10%	15
Consumer price	143		201		165

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