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minimum wage

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A minimum wage is the lowest remuneration that firms are legally required to pay their workers. It can be set on an hourly, a weekly or a monthly basis. The first country to introduce such legislation was New Zealand in 1894. In 2012, countries either have adopted minimum wages set at the national level with varying rates for defined age groups, or, have minima included in collective negotiations with unions' representatives. The second group includes Germany, Austria, Italy, Switzerland, and the Scandinavian countries. The majority of countries have, however, nationally applicable minimum wages (most notably, United Kingdom, United States, Japan, Korea, Brazil, India, France, Spain, Portugal, and most countries in central and eastern Europe).

Minimum wages are adopted with two main welfare enhancing aims: the prevention of poverty and the reduction of pay inequality amongst workers. It has become increasingly documented that minimum wages adopted in isolation are not the best instruments to address the first aim whereas they are efficient instruments to address the second one.

Poverty is indeed widespread amongst people out of work (whether inactive or unemployed). Minimum wage will leave those people unaffected by the policy. Also, low-paid young people living in rich households may potentially benefit from minimum wages. There are also potential job losses for low-paid individuals if firms decide to shrink their workforce for jobs where the productivity is falling below the minimum wage.

Recent body of evidence in the literature (mostly from the United States and the United Kingdom with some exceptions) is, however, that current levels of minimum wages do not lead to significant jobs losses (with the exception of France). The relatively low level of minimum wage setting is possibly the results of earlier findings (in the 1980s) that setting minimum wage too high led to jobs losses. The agreement was then that a 10% increase in minimum wage would lead to decrease of youth employment of between 1 and 3% (Brown, 1988). Those results have been influential on policy makers despite a large subsequent body of research in the 1990s showing very small job losses, if any at all (Card and Krueger, 1995).

To give an example, the introduction of national minimum wages in Britain, in April 1999, were originally set at rather low levels (with around 7–8% of workers affected). Despite predictions of dire consequences for low-paid workers, the vast majority of published evidence shows that firms did not significantly reduce their employment of low-paid individuals (Stewart and Swaffield, 2002; Stewart, 2002, 2004). There is some evidence that it did affect their profit (Draca, Machin, and Van Reenen, 2011), in particular for sectors where low-paid workers constituted large sections of the workforce (such as care homes).

But the level of minimum wages appears to be highly correlated with wage inequality (the second justification for adopting minimum wages). Influential work conducted by DiNardo *et al.* (1996) showed that a very substantial portion of the large increase in wage inequality observed in the United States over the period (1973–1992) could be attributed to the erosion of real minimum wages over this period. Also, recent results show that the introduction of the minimum wage in the United Kingdom in 1998 prevented efficiently the wages at the bottom to fall further behind leading to reduction in inequality, particularly at the bottom of the wage distribution (Dickens and Manning, 2004).

The extent to which minimum wages will affect wage inequality is largely dependent on the number of workers paid below its level before its introduction (or uprating). Countries with more unequal wage distribution will have more workers affected by a given minimum wage level (in particular the United States and the United Kingdom). But the effect of minimum wages on equality is also dependent on the presence or absence of spillovers on workers not directly affected. Spillovers happen when firms react to an increase (or introduction) of a minimum wage by adjusting upwards not only the wages of those directly affected but as well as those higher up the wage distribution (allowing them to maintain a given spread of wages across their workforce). If this happens in many firms, then the impact of minimum wage on inequality will be reduced.

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Initial results in the United Kingdom suggested that few workers positioned further up the wage distribution had been affected by wage increases, therefore no spillovers could be detected (Dickens and Manning, 2004; Stewart, 2012). More recent works appear to show that subsequent increases may have had more spillovers (Butcher, Dickens, and Manning, 2009). But overall, there is broad agreement that minimum wages in the United Kingdom has contributed to a reduction of wage inequality at the bottom of the distribution with few effects on employment, which may explain its popularity in this country on both sides of the political spectrum as well as among firms and their workers (Manning, 2012).

See also *cross elasticities*; *elasticity*; *factor prices*; *factor productivity*; *labor markets*; *marginal rate of technical substitution*

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