Employment Effect of Minimum Wages

Subjects: Others

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The effect of minimum wages on employment is a mature, continuously researched topic. This study discusses the core theoretical approaches on the relationship between the minimum wage and employment, which is reflected by the empirical results from the international literature. Moreover, it presents the findings of the most recent research and the results of meta-analyses of this issue. While the theoretical approaches and outcomes of empirical studies vary, the meta-analysis demonstrates the lack of a significant correlation between minimum wages and employment. In light of the latest developments and meta-regressions, the literature does not provide a clear and definite sign of the relationship, but the trend seems to be driven towards a negative direction of the impact for the more sensitive groups. Therefore, further light needs to be shed onto this issue.

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The effect of labor market institutions and policies on the evolving pattern of unemployment in almost all countries globally has always been an important issue in economic history. The labor market characteristics and the unemployment rates between Europe and the USA, as well as among the European countries, are different. Many economists, such as Blanchard and Wolfers [1], suggest that these differences in unemployment across countries can be attributed to differences in labor market institutions and labor market regulations, which are designed to form the appropriate labor market policy.

More specifically, the minimum wage, the employment protection, the influence of the unions, the active and passive labor market policies, the unemployment benefits and the tax-benefit policies of the governments, can account for the variability of employment levels. Within this framework, this paper discusses the impact of minimum wages on employment.

The minimum wage is the lowest hourly, daily or monthly wage that employers are bound by law to pay their workers. Equivalently, it is the lowest wage at which employees can sell their labor. It is an important labor market institution which most countries all over the world (92% of the International Labour Organisation's member States) have already introduced [2]. The opinions on the minimum wage legislation are usually expressed by contradictory empirical results. One side is in favor of minimum wage, whereas the opposing view considers that minimum wage has several disadvantages for economies.

More specifically, the main arguments in favor of minimum wage are as follows: It improves the living standard of the poorest and most vulnerable groups of society since it can raise family incomes at the bottom of the income distribution, thus, lowering poverty [3]. Moreover, it enhances active demand by moving resources from higher to lower incomes, which are known to have a higher propensity to consume than the highest incomes [4].

Furthermore, it increases incentives to take on jobs [5] and encourages the activation of the economically inactive population by becoming work-enticing in terms of being able to secure a living (“making work pay”) [6].

On the other hand, minimum wage increases fail to stimulate growth and can have a negative impact on vulnerable workers during recessions [7]. In addition, it is a hindrance for firms which attempt to reduce the wage costs during trade or economic downturns, consequently generating various business inefficiencies [8]. Neumark [9] suggests that among other potential downsides, a higher minimum wage may discourage firms from employing low-wage, low-skill workers that minimum wages are intended to help, and that targeted tax credits can do a better job of reaching the poor than minimum wages do.

The minimum wage is an essential labor market tool which alleviates circumstances towards the smooth and balanced functioning of the labor market. Among the labor market policies which can correct imbalances and help the entire society, employment protection, unions, active and passive labor market policies, unemployment benefits and tax benefit policies are also considered to be significant institutions.

Many social policy economists, such as Nickel [10] and Blanchard and Wolfers [1], have suggested that the differences in the labor market institutions and policies which have been designed to assist and regulate the labor market properly can explain the differences in unemployment across countries. Within this framework, this study explored the impact of minimum wages on employment.

In the literature related to the employment effects of minimum wages, since the beginning of the research field, there has been an intense controversy regarding its impact on the level of employment and unemployment. Until the early 1990s, the majority of empirical studies agreed that the minimum wage had a negative effect on employment, relying mainly on the neoclassical approach, according to which, the minimum wage causes unemployment. However, since 1992, when a top labor economics journal (the *Industrial and Labor Relations Review*) organized a Special Issue entitled “New Minimum Wage Research: A Symposium” [11], new results have begun to emerge.

In particular, Card and Krueger’s studies overturned the old economic orthodoxy about the minimum wage. David Card was awarded the Nobel Prize in 2021, and Alan Krueger would have been awarded it as well if he had not passed away. Card and Krueger challenged the conventional wisdom in labor economics, providing evidence that the increase in minimum wages is not necessarily accompanied by a decrease in the employment level.

Initially, Card [12], in a case study of California using data from the time period 1987–1989, found that the increase in the minimum wage in California in 1988 did not lead to a decline in teenage employment or job losses in the retail trade. In another study of the same year, Card [13] investigated the impact of the increase in the federal minimum wage in April 1990 on teenagers’ employment and did not find evidence of a disemployment effect on teenagers.

A few years later, Card and Krueger [14] compared the evolution of employment in the fast-food industry of New Jersey, which raised its minimum wage in 1992, with the growth in employment of Pennsylvania, a neighboring state which did not raise it. They concluded that the employment effects of the minimum wage increase ranged from non-existent to marginally positive. This study accelerated the already renewed interest of researchers in the employment effect of minimum wages and was a point of reference for a large series of related empirical studies.

Neumark and Wascher were one of the greatest opponents of Card and Krueger's results and directly challenged their conclusions. Neumark and Wascher [15][16] used the payroll statements of the fast-food chains in the US (instead of data from interviews, as Card and Krueger did), comparing the states of New Jersey and Pennsylvania, and found that an increase in the minimum wage resulted in a decrease in jobs for unskilled workers.

In 2008, Neumark and Wascher published their book entitled *Minimum Wages*, where they analyzed over 300 studies on the minimum wage which had been conducted in various countries all over the world since the beginning of the 1990s [17]. According to the authors, the majority of the studies had revealed the negative employment effect of minimum wages.

Within this framework of contradictory empirical results, it has to be highlighted that the dominant point of view in the related literature was that minimum wage had a negative effect on employment. This was the situation until 2009, when another breakpoint publication on this issue arose. This was the article by Doucouliagos and Stanley [18] published in the prestigious *British Journal of Industrial Relations*.

In their review of 64 studies on the effects of the minimum wage on teenage employment in the USA, Doucouliagos and Stanley [18] found that the empirical literature was contaminated by publication selection bias. Once this publication selection was corrected, the average impact was close to zero, and the average elasticity of the meta-analysis was found to be around −0.01.

Since then, more voices began to appear in the foreground which argued that the increase in the minimum wage does not cause any negative impact on employment. The International Labor Organization (ILO) supports the institution of the minimum wage. Specifically, 90% of ILO member states have set one or more minimum wages through collective bargaining or through statutory interventions [19].

Moreover, the International Monetary Fund (IMF) considers that the minimum wage, as well as employment protection legislation and collective bargaining, helps to achieve low unemployment and growth [20]. In addition, the Organization for Economic Co-operation and Development (OECD) is in favor of minimum wage; however, in recent analyses, it has been recommended that minimum wages should increase at a lower rate than the average wage in order to create better chances for low-wage workers [21].

This study aimed to fill in a gap in the literature by offering a comprehensive analysis of the extant literature on the employment effects of minimum wages, identifying the theoretical approaches and presenting the most recent results of the empirical research, as well as the meta-analyses that have been conducted on this issue.

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