The minimum wage – neither a job killer nor a panacea

Description

Ioannis Tirkides*

The economic debate on the minimum wage, either its introduction on a national scale or its raise to a higher level, is no longer as controversial as it used to be. There is by now a substantial body of theoretical and empirical research in the economics literature, that refutes earlier findings that argued that minimum wages kill jobs. They do not, provided they are set right at a modest level. Finding that level may be more of an empirical than a theoretical question, but typically a wage at about 55% of the median income can be modest enough. Available data from the Cyprus Statistical Service, though limited in scope and length, can throw light on some of the goods and bads of the Cypriot labour market and allow us to reach certain conclusions. In short, the introduction of a national minimum wage as above, will not cause jobs losses. It will neither change the average income in the economy by any considerable extent, nor will it change the income distribution to any noticeable degree. It might, on the other hand, create incentives that will boost productivity and that will better the employer-worker relationship. We discuss these issues in this article.

Arguments against minimum wages, have always rested on their presumed negative impact on jobs. Economic theory would say that in a near perfectly competitive world, price setting of any form, will be damaging by causing a disequilibrium. A wage higher than its natural level, defined as the equilibrium wage in competitive conditions, would force the economy to operate at a point on its labour demand and below its supply curve, leading to fewer hires and thus jobs losses. But in the real-world, economies are not perfectly competitive, nor nearly so, and the laws of economics are not akin to the laws of Physics. The predictions of economic models are subject to uncertainty and to changing behaviours and derive from a set of assumptions that can be wrong. There is friction in hiring and firing, and workers can remain unemployed for long periods at a time. Markets do not work flawlessly and the relationship between the minimum wage and employment is more complicated than what a near perfectly competitive model would predict.

Empirical studies of the impact of minimum wages on jobs, from the 1990s and after, fail to find a strong link between the two. For instance, the seminal work by David Card and the late Alan Krueger, 'Myth and Measurement: The New Economics of the Minimum Wage', published in 1995, concluded that much of the existing literature at the time, on minimum wages and jobs, was flawed. Later studies in the UK for the introduction of the minimum wage in 1999, and then for raising it in 2016, or studies on Germany's introduction of a national minimum wage in 2015, do not find any significant link between minimum wages and jobs. There is thus a growing consensus that when set at modest levels, the minimum wage will not reduce employment. At such levels minimum wages are only a small share of operating costs, so firms can absorb them either by cutting non-wage costs or by raising productivity or both.

Looking into remuneration scales over time, the available data is scant. Measures of income inequality that are based on the distribution of income, such as the so-called Gini coefficient, are not readily available. We also appreciate that the allocation of the economy's output or income, between labour compensation, and capital or operating surplus, may have not moved much on average in the European Union in the last couple of decades. But two things are clearly borne out. One is that wages have stagnated in real terms over a long period of time. Two, the distribution of employees by monthly gross earnings, is now more negatively skewed, which means, there are many more workers at the lower income scales.

The Cyprus Statistical Service provides statistical information on the distribution of employees by monthly gross earnings, for a limited period from 2010 to 2020. This is a small data set but when analysed, it can provide some useful insights. We discuss below.

The first thing is that gross earnings as we already noted, form a very skewed distribution with a large proportion of workers earning less than the economy average. This happens when the median income, the level at which half the employees are earning less and half are earning more, is lower than the mean or average income. Roughly, we calculated a median income from the data, of about €1375 in 2020, and an average of about €1930. These are only close approximations since the distribution of workers is measured by pay bracket, which means some accuracy is lost. The median income may be closer to €1500 according to statistical sources. The meaning of it, is that half the employees were earning less than the median in 2020, and two thirds were earning less than the average income, which is a large disparity.

The second point is that in nominal terms, wages increased only minimally in the period. The median wage was about unchanged, and the average wage increased by only 2% in more than ten years. With inflation up by near 5% in the same period, real wages actually declined.

Third, the quality of the jobs in the economy deteriorated. The proportion of the employees earning €750 or less increased from about 10% in 2010 to 15% in 2020. The proportion of the employees earning more than €750 but less than the average income, dropped to 57% in 2020 from about 64% in 2010. This group of workers shrank by 6.6 percentage points in the overall distribution. Of these, two thirds moved to lower incomes and one third moved to higher incomes. So, the economy in this period produced more lower income and lower skill jobs than higher income and higher skill jobs.

Last, doing the arithmetic of instituting a national minimum wage, at the levels being discussed between €850 and €950, will raise the average wage in the economy by €35 to €50 assuming all other wages will not be affected. But in real terms, this will still be lower than the average wage of more than ten years ago.

To conclude. Most of the arguments against a minimum wage have proved misguided but we need to be realistic about what a minimum wage can and cannot achieve. The minimum wage can tackle the extremes of low pay. It may reduce poverty a little, but on its own, it will not offer a solution for it. It will neither boost the earnings of the average worker, nor alter the income distribution to any noticeable degree. The real problem in western economies is the nature and quality of the jobs they generate, which reflects the weaker recovery and slower productivity since the great recession of 2008 and even before. Ultimately, the real problems are far more complex than the introduction of a minimum wage.

*_Ioannis Tirkides is the Economics Research Manager at Bank of Cyprus and President of the Cyprus Economic Society. Views expressed are personal._