

# Should We Abolish The Minimum Wage?

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**Abstract:** The discussion on minimum wage is a long-standing debate in economics. The fundamental objective of a NMW is to assist individuals who are remunerated at a low wage that yields below average living standards. To mitigate poverty, the government enacts laws that compel companies to compensate their employees at a wage that surpasses the equilibrium free market price for labour. On the other hand, an increase in the national minimum wage may also lead to an increase in the social unemployment rate. This essay will examine and critically evaluate the merits and drawbacks of NMW policies, and conclude that governments should not abolish the minimum wage altogether.

**Keywords:** NMW; Unemployment Rate; Social Welfare.

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## 1. Introduction

One of the most prominent and contentious issues in the field of economics in the past two centuries is the enactment and regulation of National Minimum Wage (NMW) policies. Rizov, Croucher and Lange (2016) assert that, in the aftermath of the 2008 global financial crisis, the challenges of managing the wages at the lower end of the distribution and balancing efficiency and equity have become more pressing for both managers and governments worldwide. NMW policies have various potential benefits, such as safeguarding the rights of workers and promoting social justice. For instance, some economists postulate that increasing the NMW could enhance the living standards of low-income workers and alleviate poverty. However, contrary to this intention, many economists contend that the implementation of NMW policies could have adverse effects on the welfare of low-earning families, such as through increased unemployment resulting from layoffs due to the higher labour costs for employers. This essay will examine and critically evaluate the merits and drawbacks of NMW policies, and conclude that governments should not abolish the minimum wage altogether.

## 2. Pros and Cons of Setting a Minimum Wage

Theoretically, the fundamental objective of a NMW is to assist individuals who are remunerated at a low wage that yields below average living standards. To mitigate poverty, the government enacts laws that compel companies to compensate their employees at a wage that surpasses the equilibrium free market price for labour. Due to escalating wages, the individuals who are remunerated at the NMW will have more disposable income, thereby augmenting their quality of life. As living standards improve, the impoverished population will contract. Based on the reduction of poverty relief and benefits, the government can profit from diminished spending expenditure, potentially reallocating the funds into education, health or other productive means. Additionally, the ensuing increase in consumer spending could concomitantly have a positive multiplier effect on the macro economy. Saget's research demonstrates that the minimum wage might have an impact on informal wages in some middle-income developing countries with low levels of

minimum wages. Furthermore, on a small number of occasions, it appears that the minimum wage has contributed to poverty reduction in poorer countries as well (Saget, 2004). Another perceived advantage of NMWs is that employees will have better morale due to their enhanced welfare. Consequently, employees will acquire a further sense of belonging within their jobs, which will reduce corporate churn. Companies in turn will expend less money on hiring and finding new labour, with employees also benefiting from an overall reduction in job related relocation expenses. In 2004, Sutherland and Holly conclude that the main contribution made by the NMW to poverty reduction at the household level is probably through its role in underpinning the operation of in-work top-up benefits (Sutherland and Holly, 2004).

However, the debate against NMWs also encompasses some vexatious issues. Orthodox economic theory postulates that NMW augments the rate of unemployment. In a free market for labour, the original equilibrium point is in the nexus of the supply and demand curves. Under the impetus of the free market, the supply equates the demand, so the number of jobs can satisfy the need of the workers, ensuring no unemployment. Subsequent to the government introducing the NMW, the price of labour is fixed at a higher wage, which is higher than the equilibrium point. The supply of labour would increase, as more people are disposed to work at the higher price level, leading to an excess of supply. However, the quantity of labour demanded will diminish, as some companies are incapable of sustaining production at a higher labour cost basis. The new equilibrium point would be the intersection between the NMW and demand curve at above the equilibrium generating an output gap. With a NMW higher than the equilibrium price, the supply of labour would be greater than the demand for labour, ensuring there will be an excess of supply. In this scenario, there would be unemployment. Mark and Jamie examine long term unemployment rates and state data from the latter 1980s, a distinctive period when many states elevated their minimum wage above the federal level. Their results imply that a greater minimum wage increases long term unemployment rates. With further evidence indicating that increased minimum wage coverage also escalates long term unemployment rates (Mark & Jamie, 2010). But concurrently, some economists demonstrated that NMW would not increase unemployment. In 2014, Pavelka and his research group shows that there is

no lucid relationship between the minimum wage and the unemployment rates in the Czech Republic by analysing data (Pavelka et al., 2014).

Tim Maloney conducts a meticulous examination of this issue by employing specific data until the conclusion of 1993 to determine whether the adult minimum wage had disparate labour market repercussions on young adults aged 20 to 24, in contrast to the “control group” of exempt teenagers. Maloney approximates that a 10 percent escalation in the minimum wage curtails the employment of all young adults by 3.5 percent, and amplifies their unemployment rate by 3.5 percentage points. The same escalation in the minimum wage curtails the employment of all young adults devoid of school or post-school qualifications by 5.7 percent, and amplifies their unemployment rate by 6.5 percentage points (Maloney, 1995). This effect on the aggregate is seldom disputed. Consequently, another paramount detrimental repercussion of NMWs would be the effective underemployment of young people with no experience. Managers favour more experienced and more productive employees instead of younger workers at the same price. Because the younger workers generate less value in their jobs than the minimum wage. In this manner, inexperienced people encounter impediments in finding jobs while jobs without experience, engendering a vicious circle. As such, there is a plethora of valuable labour that is incapable of contributing towards society. As Lucas and Keegan articulated in 2007, the young people are actively discriminated against due to factors pertaining to lower skills and pay (Lucas & Keegan, 2007). Moreover, Partridge and Partridge in 2006 asserted that both a greater minimum wage rate and greater minimum wage coverage augment teen unemployment rates (Partridge & Partridge, 2006).

After the implementation of NMW, the price of labour will escalate. To compensate for the labour costs, most companies would opt to augment the prices of their services and goods which implies transferring new costs to consumers. Inflation can be induced by either an expansion in the money supply, from either demand pull or, in this case, cost push inflation. Therefore, although in absolute terms minimum wages have ascended, they have potentially stagnated or declined with the rising cost of living. The average consumer could effectively undergo a decline in purchasing power if producers transfer the higher costs to the consumers. For those on the minimum wage, this would be so if the surge in prices is proportionately larger than the enhancement in the minimum wage. This entails a relative decline in the quality of life. For those people who are not employed, this issue is aggravated, as they are unable to afford the product even in the higher prices. The affordability of products is exacerbated by the elevation in prices.

Reevaluating the role of NMWs and inflation, Nguyen Biet Coung contends that inflation, as measured by a monthly overall Consumer Price Index and a monthly food CPI, is instigated by external macroeconomic events and not by minimum wages (Cuong, 2011). Employing general equilibrium model analysis, Phillips curve estimation analysis, input-output model analysis, difference-indifference estimation analysis and regression analysis, Sara Lemos 2004 discovered that NMW does not elevate prices by any significant amount. Sara’s findings largely corroborated the Phillips model by assumed augmentation in unemployment did not increase the inflation rates (Lemos, 2004).

Data from Our World in Data, [https:// ourworldindata. org/](https://ourworldindata.org/)

This essay endeavoured to contribute towards the National Minimum Wage debate by examining the assumption that higher national minimum wages engenders higher unemployment by utilizing a bivariate regression analysis. By collecting minimum wages and unemployment rates for a collection of 31 affluent and impoverished countries, this essay then plotted them in a scatter form and applied a line of best fit. The above diagram depicts the correlation between NMW and unemployment rate.

In the diagram, albeit there is a negative linear correlation between NMW and unemployment rates, this correlation is very feeble and susceptible to influence by outliers. Intriguingly, as the NMW escalates, the unemployment rate ostensibly declines, which is utterly contrary to our theory. We can lucidly see that even if a country has a high NMW, they can have a low unemployment rate, such as Luxembourg. Similarly, in Costa Rica, the national minimum wage is merely \$3,37 per hour while it still has a very high unemployment rate at 22%. In certain circumstances, a high minimum wage does not engender high unemployment in a country. This might be because each country has different political background and economic situation.

By employing the term Spearman’s rank correlation coefficient, 0.1496. The significance level is too low so we can surmise that there is a minuscule and potentially spurious association between NMW and unemployment rate.

In fact, there is a copious literature on the repercussion of minimum wage augmentations on employment, and most of them arrive at the same conclusion: when minimum wages ascend, employment will ascend rather than decline. For instance, Card and Krueger scrutinized 410 fast food restaurants in New Jersey and Pennsylvania before and after the elevation in the minimum. The result exhibited stores that were unaffected by the minimum wage had the same employment growth as stores in Pennsylvania, while stores that had to increase their wages increased their employment (Card & Krueger, 1993).

However, by eliminating the outliers, the graph then forms a flawless linear correlation suggesting any initial negative linear association between unemployment and national minimum wages could again be spurious or at least have negligible effect – at least for this dataset. Despite the above indecisive analysis, but based upon the literature, this essay can contend largely that NMW would not play a significant role in augmenting the unemployment rate.

### 3. Conclusion

Overall, NMWs can augment the low wages of the impoverished, elevating people’s living standards and enhancing employee morale. Although it cannot target poverty alleviation efficaciously, however, on the macro level it can diminish the number of people who living in poverty. Additionally, the practical significance should not be disregarded. When the NMW is at a suitable interval, it can ensure that the rights of employees who benefit from this policy are not violated. This can also ensure the civil rights and people’s livelihood. As a result, the externalities of NMWs could bring an incalculable social benefit.

There is no refuting that there are some drawbacks from NMW. Hence, governments should be very prudent in elevating minimum wages. However, unless the minimum wage is too high than the equilibrium wages, the harm it bring is minimal or it can be rectified. As a result, NMW is valuable and beneficial, the point is how to establish a proper minimum

wage. Economists should consider the elastic of labour supply for different jobs, as well as the employment situation in different region. Governments should according to the regional microeconomics of a countries labour market set the appropriate NMW interval and try to minimize the negative repercussions of the minimum wage. For example, they can focus on help unemployment people by providing assistance and employment opportunities. Overall, the existence of NMW is very rational. It should not be abolished due to the advantages overweight the disadvantages. In conclusion, setting up a minimum wage is not a flawless policy, but the influence of NMW is largely positive, and thus should persist.

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