Economic growth is not likely to produce big falls in OECD unemployment in the near future...

OECD area GDP grew by just over 3 per cent in 1997, its best performance since 1989, in spite of the Asian financial crisis. Growth is projected to average about 2½ per cent in 1998-1999, though prospects are very different across the regions. As a result, the unemployment rate is likely to fall only very slowly through 1999 to about 7 per cent, or more than 35 million job-seekers.

... so governments still assign a high priority to policies to increase employment...

Progress in tackling high unemployment has been quite mixed across countries. Over the 1990s, structural unemployment has declined in just six countries – Australia, Denmark, Ireland, the Netherlands, New Zealand and the United Kingdom. It has remained stable at a low level only in Norway, the United States and Japan, although in the latter, the unemployment rate has risen sharply recently and is of concern. Therefore, reducing unemployment and expanding job opportunities remain a high priority and will require a range of measures, including sound macro-economic policies – a message reinforced at the October 1997 meeting of OECD Labour Ministers. They, in particular, requested the OECD to assign a high priority to monitoring and evaluating alternative approaches to an employment-centred social policy to increase employment, and reduce welfare dependency and poverty. This topic is also being debated by OECD Social Policy Ministers on 23-24 June 1998.

... and want social protection measures, such as minimum wages and in-work benefits, to be part of the strategy to promote employment.

This editorial addresses the potential roles that minimum wages and employment-conditional benefits can play as part of an employment-centred social policy. The underlying premise is that social protection systems can alleviate family poverty, but they are insufficient for promoting wider participation in society unless they are closely tied to measures to promote labour market integration.

The benefits and costs of minimum wages need to be looked at objectively...

As shown in Chapter 2, statutory minimum wages currently exist in 17 Member countries and are slated to be introduced soon in two others (Ireland and the United Kingdom). In other countries, minimum wages are established by collective agreement and, hence, tend to vary by sector. Analysis of statutory minimum wages arouses strong passions on the part of both proponents and opponents and there is a wide range of theoretical and empirical results on their effects. In order to assess their potential contribution to an employment-oriented social policy, a dispassionate and ongoing assessment of their benefits and costs is required.

... including their effects on earnings inequality, poverty, incentives and employment levels...

In the context of concerns about growing earnings inequality and in-work poverty in a number of OECD countries, statutory minimum wages can play a role in preventing earnings from falling below socially acceptable levels. Indeed, their basic purpose is often presented as ensuring fair pay in the labour market and helping reduce in-work poverty. They may also increase incentives to enter the labour market and find work ("making work pay"). On the cost side of the ledger, they may give rise to disemployment effects.
so we need to know which workers gain, the effect on inequality and poverty and whether jobs are lost. Following a brief look at the level and coverage of minimum wages in OECD countries, three questions are addressed: Who are the workers most likely to be affected by a minimum wage? What is the impact of minimum wages on earnings inequality and family poverty? What is the evidence on the employment effects of minimum wages?

Minimum wages are set at very different levels across countries. The level of statutory minimum wages varies greatly across countries, ranging from 20-33 per cent of the median earnings of full-time workers in the Czech Republic, Japan and Spain, to around 60 per cent in Belgium and France. Not surprisingly, the higher the level of the minimum wage relative to average or median earnings, the lower is the proportion of low-paid jobs in total employment (Chapter 2). In addition, higher minimum wages are also associated with less inequality in earnings between men and women, and younger workers compared with adults.

The main beneficiaries are young workers and women... The beneficiaries of a minimum wage are low-wage workers. Youth and women are the groups most likely to be in minimum-wage jobs. And, as shown in the 1997 Outlook, it is particularly women and the less skilled who are most likely to be trapped in low-paying jobs, whereas for many youths they are often a stepping stone to better paying jobs.

... and lower-paid workers in higher-income families may also gain... However, a criticism of a minimum wage is that it fails to “target” efficiently those workers in families who really need help. Instead, it also helps many workers in households with median incomes and above because many low-paid workers live in such households, while it fails to help households with no workers at all.

... indeed most full-time, low-paid workers are not in poor households... There are large differences across countries in the overlap between low pay and low family incomes when all families, regardless of their work status, are considered. Around 20 per cent of full-time/full-year low-paid workers live in poor households in European Union countries, rising to almost 40 per cent in the United States. Thus, many poor people live in households with nobody in paid work: on average for the OECD as a whole, roughly 40 per cent of low-income individuals live in such households.

... so rises in minimum wages have low impact on overall poverty. The fact that low-paid workers are not highly concentrated in poor households suggests that increases in statutory minimum wages, in most cases, are likely to have a limited impact in cutting overall family poverty rates. This distributional case for minimum wages is, therefore, weak. However, it should also be emphasized that weakening or reducing the generosity of the welfare system, especially in tandem with declines in minimum wages, could risk increasing the extent of in-work poverty.

On the cost side, minimum wages seem to have destroyed some teenagers’ jobs, though accounting for only a fraction of all those lost, with no discernible impact for adults... One of the strongest criticisms of minimum wages is that, to the extent they are set at above market-clearing levels, they will price some people with low productivity out of jobs. The large number of country-specific studies have yielded a range of empirical estimates. A few recent American studies suggest no employment impact, although the balance of the evidence suggests some adverse effects on youth unemployment. The evidence for nine countries provided in Chapter 2 suggests that higher minima adversely affect teenage employment: a 10 per cent increase in the minimum is associated with a 1½ to 3 per cent decline in teenage employment, the effects being essentially the same across countries regardless of whether they have high or low minimum wages. The evidence also shows that hikes in the minimum, on their own, can explain only a small fraction of the large observed falls in teenage employment rates over the past two decades in almost all countries. The cross-country
Evidence suggests that the minimum has no significant impact on overall adult employment.

Employment losses for young people lead naturally to the question of whether there should be flexibility in setting a separate minimum for young people. This is important because of the widespread desire to facilitate a better transition from education to the world of work. Indeed, as shown in Chapter 3, there are large cross-country differences in the proportion of new school leavers who find jobs quickly, with the highest likelihood in those countries where many youths go through apprenticeship programmes (e.g. Austria, Germany and Luxembourg). Young people undergoing apprenticeship training are usually paid a relatively low wage or allowance. Hence, it seems desirable in countries which have a minimum wage to apply a lower rate to young people, and a number of countries already do this.

Minimum wages are neither the solution to overall family poverty nor the general scourge on jobs that opposite sides proclaim...

The overall effectiveness of statutory minimum wages as part of an employment-centred social policy depends crucially on their interactions with tax/benefit systems and the size of any disemployment effects. The policy debate on the role of statutory minimum wages as part of an employment-centred social policy encompasses a range of views. Some continental European countries have opted for fairly high minimum wages coupled with payroll tax cuts and/or wage subsidies targeted on low-wage workers. Others support somewhat more modest minimum wages with employment-conditional benefits to top-up the incomes of families with low incomes, and view these two instruments as complementary. Finally, some doubt the complementarity of minimum wages and employment-conditional benefits on the basis that minimum wages may reduce employment and that employment-conditional benefits can more effectively achieve redistributional goals.

In-work benefits have the advantages of being targeted to needy families and protecting against temporary income falls...

There are two important positive features of a judiciously implemented policy of employment-conditional benefits. First, they are better targeted than a minimum wage to deal with in-work poverty among families. Second, in an era of high perceived job and earnings insecurity, they can act as a form of temporary earnings “insurance”. One estimate of eligibility for the US earned income tax credit (EITC) suggested that, while in any single year only about 1 in 6 families are eligible for the EITC, over a ten-year period 2 in 5 families will have one or more years in which their wage income declines so much that they would become eligible.

... but they are costly, potentially allow employers to capture the benefit, and create poverty traps...

However, on their own, employment-conditional benefits are not a panacea. They can be quite costly to the public purse, much more so than a minimum wage which is “paid” for by firms and consumers rather than taxpayers. They have also been criticised on grounds of “moral hazard”, i.e. the possibility that merely offering such “insurance” can change behaviour in undesirable ways. While they are intended to subsidise workers, they may end up subsidising employers. In the absence of an effective wage floor, this could come about either through the benefits having such a large supply effect that wages are driven down or through collusion between firms and workers to keep wages low knowing that the government will make up the difference. There is, however,
little evidence that current schemes have had this effect. Means-tested benefits also create high effective marginal tax rates (poverty traps) where individuals have little incentive to work more hours or expend more effort.

In short, policies on minimum wages or employment-conditional benefits should not be considered in isolation. Their strengths and weaknesses on distributional and efficiency criteria can be complementary. For this beneficial effect to occur, however, both have to be set jointly and be seen as part of an overall package for alleviating some work disincentives, and the unemployment and poverty traps which face many low-earning workers. The fact that complementarity of these two measures is dependent on setting them jointly, highlights the fact that their respective levels are crucial.

While specifying “optimum” levels is difficult, as a rule the higher the minimum wage and the lower the earnings thresholds for entitlement to employment-conditional benefits, the less likely these two measures are to be complements. The difficulties facing countries in this domain are also mirrored in current policy stances. To simplify, the lower are minimum wages relative to average or median earnings and the more unequal the earnings distribution, the more likely are employment-conditional benefits to be used. The more compressed the earnings distribution, the more likely countries have been to use tax abatements or employer subsidies to stimulate hiring of less qualified workers, often also at a high budgetary cost. The bottom line is that the interactions between tax/benefit systems and minimum wages are complex, and designing the appropriate policy mix will depend greatly on individual country circumstances.

A well-designed policy package of economic measures, with an appropriately set minimum wage in tandem with in-work benefits, is likely, on balance, to be beneficial in moving towards an employment-centred social policy. Empirical work is scanty, but urgently needed on how to design such a package. Ideally, the objective must be to improve labour market conditions so that the “earnings insurance” implicit in statutory minimum wages and in-work benefits is less and less needed by unskilled workers. However, even a well-designed policy package would leave no room for complacency. First, it is not clear how effective the change in work incentives from such measures will be. Second, not all people will be able to take full advantage of such incentives and they must not be left out in the cold if social cohesion is to be more than a slogan. It is important that everyone who is able, be given the appropriate help to participate in the labour market through the provision of social and labour market services, help with child-care costs and the like.

The long-run well-being of individuals on the bottom rung of the economic ladder depends both on increasing their employment opportunities and raising their productivity. It is only by directing attention to the additional need to develop long-run policies to increase the skills and competences of the less skilled, and to encourage the businesses where they work to invest in this human capital, that further sustained progress on improving the standards of living of disadvantaged groups in OECD countries will be possible. The policy package outlined above should help to focus the debate on this crucial issue.

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