

Lecture 2. The Labour Market and Minimum Wage law

1. The rationales for the minimum wage law

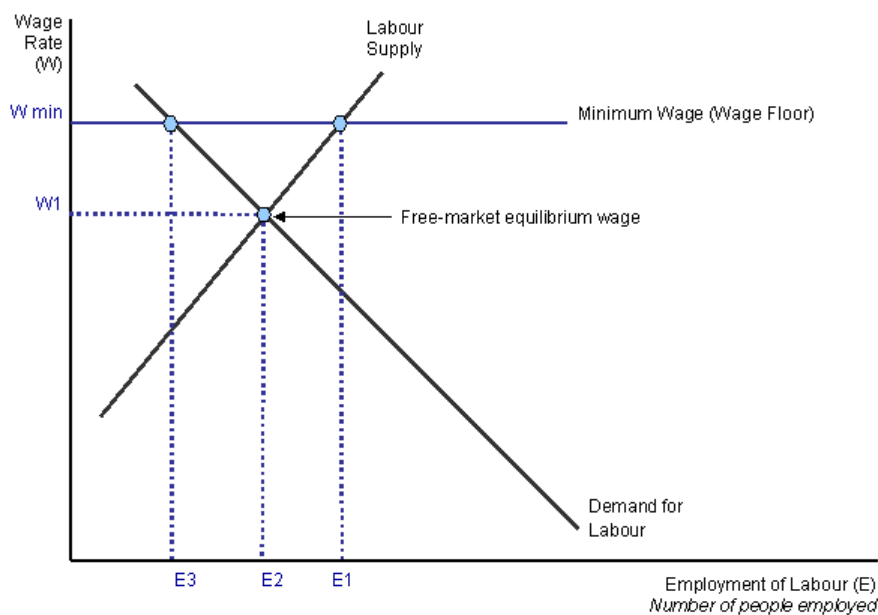
- Equity consideration: to combat poverty and reduce inequality
- Incentive to work: to improve the incentive for people to look for jobs and thereby reducing government welfare expenditure
- Combat discrimination: females or minorities may suffer from discrimination in the labour market and their pay may not commensurate with their productivity

Minimum wage law sets a statutory wage floor for the labour market. However, it cannot guarantee to give you a job.

2. The effect of a minimum wage law

(1) Under perfect competitive labour market

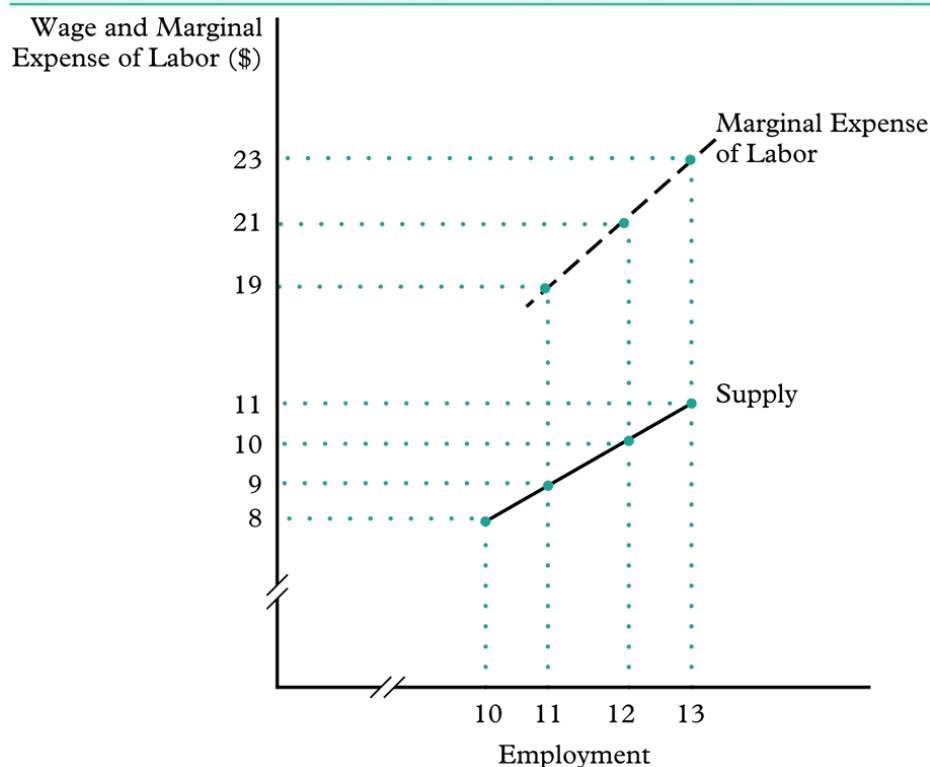
Under *perfect competitive labour market* and *hold other things constant* a minimum wage law hurts employment:



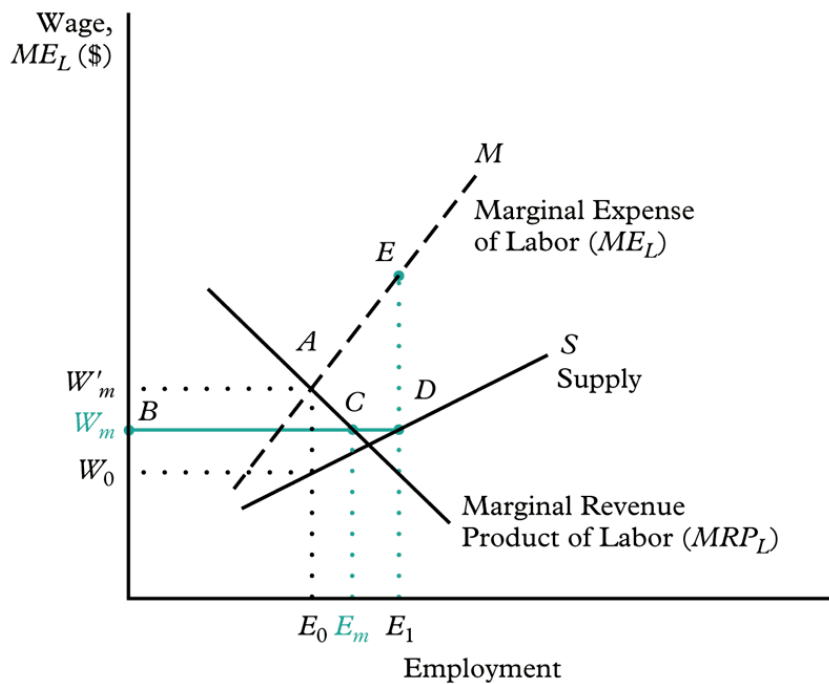
(2) Under monopsonistic labour market

When the labour market is monopsonistic (firms have monopoly power on labour demand perhaps due to labour mobility cost), firms face an upward sloping labour supply curve and hiring an extra worker raises pay for all workers and firms' marginal expense of labour exceeds the wage rate. To see why this is the case, one can look at the following textbook hypothetical example:

Offered Wage	Supply of Labor	Total Hourly Labor Cost	Marginal Expense of Labor
\$8	10	\$80	
\$9	11	\$99	\$19
\$10	12	\$120	\$21
\$11	13	\$143	\$23

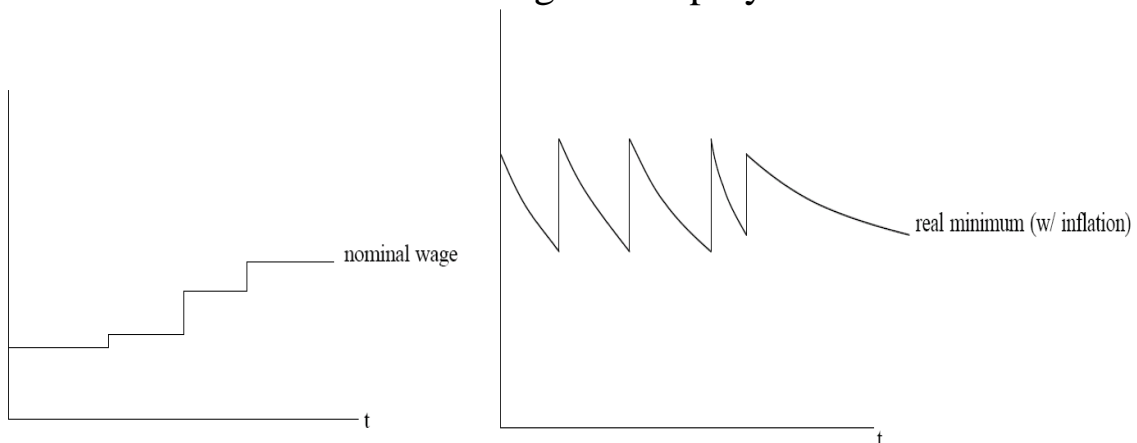


If a minimum wage, W_m (which is higher than the ruling equilibrium wage, W_0), is set for a monopsonistic labour market, the employment rate can actually rise from E_0 to E_m . This is because while the wage rate has been increased firms' marginal expense of labour has actually decreased due to a horizontal labour supply curve caused by the minimum wage. (see the textbook diagram below)

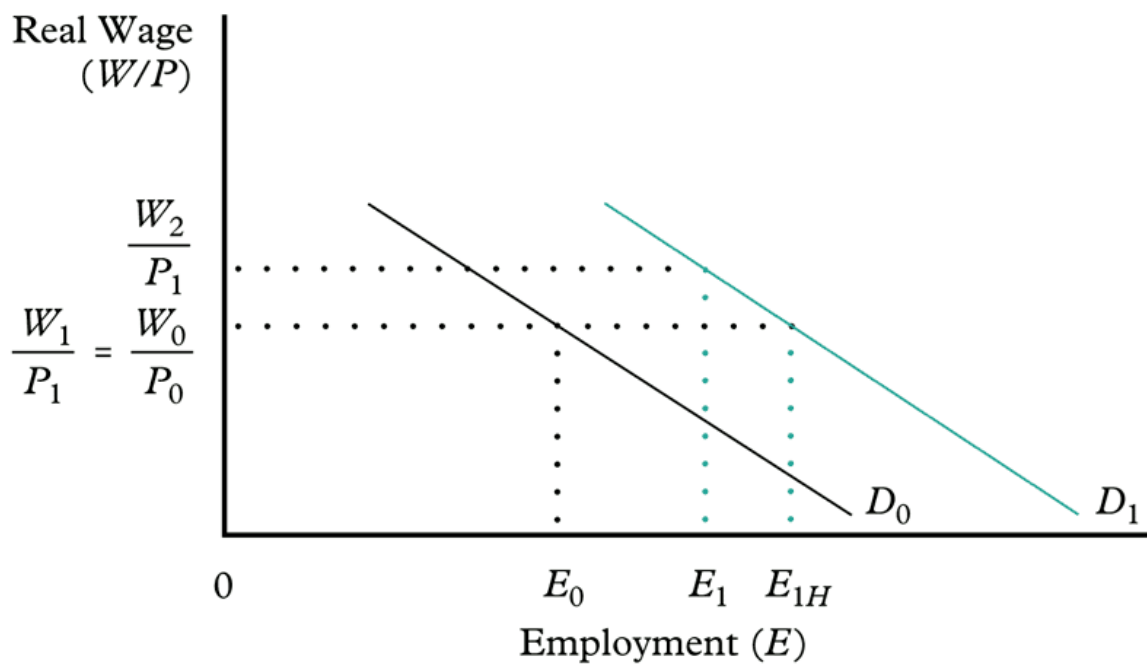


(3) Other factors to consider

- Minimum wage is set at nominal level. However, it is the real wage that really matters for labour demand. If an increase in nominal minimum wage is matched by an increase in price level, the effect of the increased minimum wage on employment will be diluted.

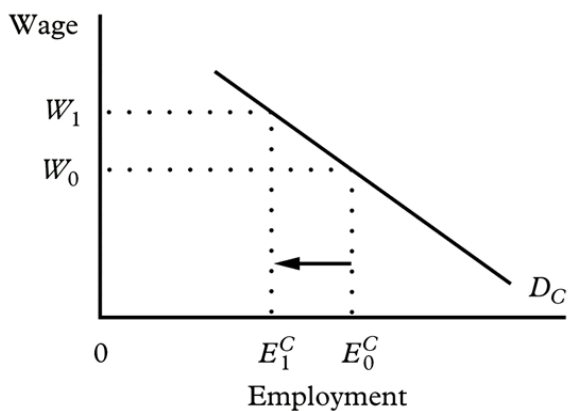


- The labour demand is also affected by other factors, such as product demand and technology. Facing a constant changing labour demand curve, it is difficult to assess the employment effect of the minimum wage legislation.

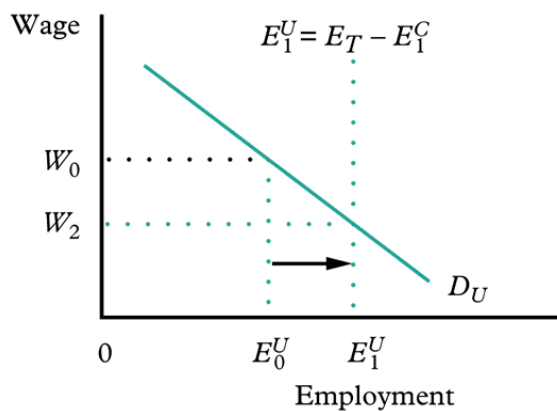


- The employment effect of a minimum wage law is also affected by whether there is an uncovered sector.

(a) Covered Sector



(b) Uncovered Sector



- A minimum wage law may also affect fringe benefits and training expenditure.

3. Some empirical evidences

- (1) **A Case Study by Card and Krueger (1994) on the fast food industry**

Card and Krueger (1994) interviewed 410 fast food restaurants in New Jersey and eastern Pennsylvania, before and after April 1, 1992, when NJ raised minimum wage from \$4.25 to \$5.05 but Penn. did not. They found relative to PA, employment in NJ restaurants increased by 2.75 FTE. However, their study was challenged later by other researchers on data quality. Neumark and Washer (2000) used payroll data on restaurants in the same area for the same period and found the opposite result.

(2) Panel data study Currie and Fallick (1996)

Currie and Fallick (1996) used the National Longitudinal Survey of Youth in the US and looked at employment of teenagers before and after an increase in the federal minimum wage in 1979 (from \$2.90 to \$3.10) and 1980 (\$3.10 to \$3.35). They found that the employment probability was reduced by 3%. Neumark and Wascher further expanded their study and found that the changes of minimum wage also have a positive effect on school dropout rate for teenagers.

Readings:

Ch. 4,5 of Ehrenberg and Smith

David Card and Alan B. Krueger, "Minimum Wages and Employment: A Case Study of the Fast-Food Industry in New Jersey and Pennsylvania," *American Economic Review* 84, no. 4 (1994): 792. A later book expanded on these results, see David Card and Alan B. Krueger, *Myth and Measurement: The New Economics of the Minimum Wage* (Princeton: Princeton University Press, 1995).

David Neumark, Mark Schweitzer, and William Wascher, "Will Increasing the Minimum Wage Help the Poor?" *Federal Reserve Bank of Cleveland Economic Commentary*, February 1, 1999, online version at: <http://www.clevelandfed.org/Research/com99/0201.pdf>.

Neumark, David, and William Wascher. "Minimum Wages and Employment: A Case Study of the Fast-Food Industry in New Jersey and Pennsylvania: Comment." *American Economic Review* 90, no. 5 (2000): 1362–1396.

Neumark, David, and William Wascher. "Minimum Wages and Training Revisited." *Journal of Labor Economics* 19, no. 3 (2001): 563–595.

<http://www.federalreserve.gov/pubs/feds/2003/200323/200323pap.pdf>