# The effects of a binding minimum wage



### Introduction

A binding minimum wage leads to numerous detrimental effects in a competitive labour market. This essay will highlight what these effects are, and what the outcome of these effects will bring to the labour market.

A labour market is defined by Parkin as a market where "employers are on the demand side and workers are on the supply side. Firms decide how much labour to demand, and the lower the wage rate, the greater is the quantity demanded (Parkin, et al., 2008)". It is said to be competitive when there is a surplus of workers that are seeking a job, with few employer's willing to hire.

A minimum wage is a price floor implemented by the government, which ensures that an employer must pay a minimum rate of pay to an employee, and anything lower than this rate of pay is illegal. " A minimum wage is binding if it is set above the equilibrium wage (Parkin, et al., 2008)". " With a binding minimum, wage adjustments are blocked and the market is prevented from allocating labour resources (Parkin, et al., 2008)".

### **The Effects**

#### 2.1 The Labour Market due to the minimum wage

In the labour market, there is said to be an equilibrium wage. This is where the demand and supply lines on the minimum wage graph intersect, as it is the point that the rate of pay is equivalent to that of the quantity of hours worked/required. A binding minimum wage in a competitive labour market means that this equilibrium point is offset as the rate of pay must rises. This can be shown using the following graph (Parkin, et al., 2008).

#### The effects of a binding minimum wage – Paper Example

With relation to part (a) of the Parkin's graph previously, it is evident that the wage rate of  $\in$ 5 on the Y axis is the equilibrium price, and 21 million hours per week is the equilibrium quantity on the X axis. "The minimum wage is below the equilibrium wage rate and is not binding (Parkin, et al., 2008)".

Where the rate of pay has increased, and all employees are being paid a higher wage, the hiring company cannot afford to hire as many employees as it will be too expensive, because not only do they have to pay wages for the skilled jobs, they also have to pay a higher wage than they would have intended for workers to perform the lower skilled jobs. Therefore this means that there will be workers on the supply side who will not be able to get a job, thus the unemployment rate will rise. This can be shown in part (b) of the graph (Parkin, et al., 2008).

With relation to part (b), it can be seen that " the minimum wage is  $\in 6$  an hour, which is above the equilibrium wage. The equilibrium wage is now illegal. At a minimum wage of  $\in 6$  an hour, 20 million of hours of labour are demanded and 22 million hours are supplied (Parkin, et al., 2008)". This difference that has been created due to the binding minimum wage creates a surplus of 2 million hours of work per week in the graph, which means that the unemployment rate now rises. This new minimum wage also means that unemployed workers are willing to supply the 20 millionth hour for  $\in 4$  (Parkin, et al., 2008).

## **2. 2 Inefficiency of the Labour market due to the minimum wage**

The minimum wage is not efficient, as Parkin states it " results in unemployment – wasted labour resources – and an inefficient amount of job search (Parkin, et al., 2008)". When looking at a minimum wage graph, a deadweight loss is present. This occurs because of a decrease in both the workers surplus and the company's surplus. This is seen in the following graph (Parkin, et al., 2008).

Also seen in this inefficiency graph is a potential loss from job search. This loss is said to arise " because someone who finds a job earns  $\in 6$  an hour but would have been willing to work for  $\in 4$  (Parkin, et al., 2008)". This inefficiency affects the labour market as it means there is a deadweight loss of 1 million hours of work per year.

### 3. 0 What might soften my interpretation?

The use of a minimum wage brings numerous detrimental effects to people. When looking at the outcomes of a minimum wage, " it delivers an unfair result and imposes unfair rules (Parkin, et al., 2008)". Parkin also states that this is unfair because only those who can find a job benefit, whereas the unemployed end up worse off than with no minimum wage (Parkin, et al., 2008).