Example of the pros and cons of minimum wage critical thinking

Literature, Russian Literature

Summary

Minimum wage legislation is a very popular and populist issue. There are both economic and social needs to be addressed in the matter. There are also very highly opposing positions in the discussions.

There are many arguments in favor minimum wage legislation. Perhaps, the most important among them are four rationales: poverty alleviation, reduce wage inequality, employee protection, and economic stimulation. Meanwhile, among the four more important arguments against minimum wage legislation are: increased unemployment, aggravated poverty, increased high school drop-out rate and prolonged unemployment periods, and reduced global competitiveness.

In the light of the present world economic crisis, the arguments against the minimum wage legislation seem to be stronger. The solution to the problem however should be a balance between the economic and social need. Some level of wage should be maintained so that companies can continue to employ people and keep their costs down. At the same time, workers need to be protected from abuse and exploitation.

Every time there are talks of plans to legislate an increase in minimum wages, debates ensue between those who are for and against minimum wage hikes. This seems to be true in any country. The reasons for and against minimum wage increases seem to be the same anywhere.

In 2009, when a proposed minimum wage hike was being discussed in the US government, the Wall Street Journal raised the alarm about the dangers of the plan. The article warned that increasing the minimum wage at that time, which is the height of the financial crisis, could lead into greater unemployment which in turn could worsen the poverty situation. Any minimum wage hike could have more adverse effects on the economy and thus the living standards of people. (Neumark)

Very recently, just this January 2013, Forbes raised a similar alarm over the proposed minimum wage hike. The arguments against increasing the minimum wage are essentially the same as those of The Wall Street Journal back in 2009, mainly about the adverse effect of such an action on the economy. The article argues that instead of alleviating poverty the reverse would happen. (Dunkelberg)

Interestingly, some of the arguments for and against minimum wage hikes involve the same principles but with contradictory points of view. For instance, those for minimum wage hikes argue that it would help people cope with inflation; those against argue that minimum wage hikes would actually increase inflation so it would only make more people poor. (Neumark) These are just a couple of rationales for and against minimum wage hikes.

The pros of minimum wage

There many rationales for minimum wage legislation. Many of these are proposed mainly by economists themselves, government agencies related to labor, and, of course and most importantly, the labor force itself. For discussion in this paper, four rationales will be considered: poverty alleviation, reduce wage inequality, employee protection, and economic stimulation.

One of the most important arguments in favor of minimum wage setting or hikes is its impact on poverty alleviation. When people's income are increased, they will thus have more money to spend thus improve their standard of living. In a situation where people's income are stagnant and prices are going up, people's cost of living will go up but their standard of living will be going down. This may result in a greater poverty rate. So, any wage increase would help people cope with inflation and help them maintain their standards of living. Along with employment protection laws, it is also the preferable form of " assistance" over welfare to people who need additional income to cope with inflation and keep themselves above poverty. (Canada)

Those in favor of minimum wage setting and hikes also argue that these have no inflationary effect. They argue that wage increases are only a small component of production costs and in turn final prices of goods and services. So, the impact of new minimum wages would hardly affect inflation. (Wickslim)

Another argument in favor of minimum wage setting is that it reduces wage inequality. The huge gaps in wages is one of the reasons that sets people's living standards apart. Because some people earn so small an income, they remain poor. Minimum wage setting and increasing would help them climb up the social ladder. (Canada)

Minimum wages are also set to protect the employees themselves. Employees are protected against abuse of being paid very low or inhuman wages that they can barely survive on. In short, they are being protected against exploitation. Another way that labor is protected is by way of setting a floor price in the labor market. So, at the entry level, people can enjoy the same rate. This helps curb unfair labor competition wherein the lowest priced worker would always get the job. Such an environment could have serious economic consequences especially with regard to the quality of products and services and with regard to industrial or global competitiveness. It forces companies to maintain certain standards in the employment of people and at the same forces people to keep up with standards. (Canada)

Another important argument in favor of minimum wages is the stimulation of the economy (Neumark). The higher the incomes of people, the higher the aggregate demand in the economy. Increases in the minimum wage generate a cycle of growth for the economy. As people’s incomes increase, so do the demand for goods and services. As production to meet increasing demand, unemployment would decrease as producers would need more labor to meet demand. It becomes cycle of growth in demand and productivity. (Canada) The setting of minimum wages becomes again becomes important. Growth can be confined in only certain sectors of society and leave out the lower wage earners. Setting or increasing minimum wages is a way to help the poorer members of society keep in step with economic growth.

The cons of minimum wage

In the light of the world economic crisis, there seems to be more available research information against minimum wage legislation. Amid collapsing economies in Europe, Germany’s economy remained strong and even continued to grow apparently as a result of the country’s wage policies (Stockhammer). The arguments against minimum wage include: increased unemployment, aggravated poverty, increased high school drop-out rate and prolonged unemployment periods, and reduced global competitiveness.

Among the arguments against minimum wage, the unemployment issue is perhaps the strongest. As early as the 1990s, research have shown that there is a correlation between minimum wage increases and unemployment. The unemployment rate increases when the minimum wage is increased (University of Vermont). The increase in unemployment may be small but the finding runs contrary to poverty alleviation arguments. A higher unemployment is certainly not an indication of any improvement in a country's poverty situation.

Unemployment arises because employers will reduce the number of employees and demand greater productivity from the remaining employees. This is an expected and fair behavior from companies. After all, companies should expect better and greater output from employees as they are getting paid better. The impact of minimum wages would be most pronounced on the poor and the unskilled laborers. Because of higher wages and higher expectations from workers, companies would hire only better skilled and better educated workers. With reduced demand for workers, unskilled and less educated members of the labor force get left out in the job market. (Wilson)

In contradiction to the position of those in favor of minimum wages, those against it say that minimum wages actually aggravates the poverty situation. Several reasons are given for this. People who lose their jobs would seek lower paying jobs usually part-time work. They would thus earn less than before. Poverty is a function of personal and family needs relative to income. Many people who are poor are in that situation because they do not have work. Minimum wage laws do not affect them. What it affects are current workers. Displaced workers as a result would have reduced living standards and thus have become poorer. (Canada)

Minimum wages has the contrary effect on poverty alleviation because it is targeting the wrong people in the first place. They are targeted toward income earners and thus relatively wealthier families and their impact is to lower these families' incomes as a result of people losing their jobs. Minimum wage laws also positively affect only a small portion of the labor force, mainly the youth. Even if assuming that minimum wages would raise people's purchasing power, the level of wage increase at the individual employee's level would not be enough to affect his lifestyle nor improve his poverty situation. However, the aggregate amount of legislated minimum wages could have profound effects on the economy. (Canada)

One serious danger of increased minimum wages is the growth of the illegal or the underground labor market. Some jobs are low paying because they require minimal skills or require further training. Training is a actually a cost of labor. If this training is cut off in lieu of higher minimum wages, some workers are left out in the market. Some companies would illicitly hire people at lower wages and provide them the training to keep their overall cost structure within manageable levels. (Canada)

Mark Wilson, a former deputy assistant secretary of the US Department of Labor, in his study on the negative effects of minimum wage hikes, also made similar observations. In particular, he pointed out that minimum wage legislation forces employers not only to cut on the number of employees but also on training and other benefits for existing employees. This of course result in lower standards of living for those affected. Minimum wages also create an environment where job turnover increases because employers are avoiding to provide benefits to permanent employees. It is easier and cheaper for companies to hire temporary employees given the huge supply of skilled, unemployed persons. The environment may also force some people to seek low-paying , unprotected jobs. Employers may also shift to automation to minimize labor and cut costs which can have a permanent impact on the labor market. Higher wages would also mean higher costs for the producer and therefore higher prices for consumers. Minimum wages would thus have an inflationary effect. As a poverty alleviation tool, minimum wage legislation seems to have the opposite effect. (Wilson).

For workers, unemployment periods can get prolonged and employment periods shorter. This would be mainly a result of companies cutting on benefits costs so they employ on a short-term basis and demand greater output from all their employees. This was made possible by the huge supply of skilled laborers relative to available jobs.

A curious finding of some studies is that high minimum wages could result in higher school drop-out rates. Young students would opt to quit school in favor of short-term, part-time jobs. Such decisions could have serious repercussions in the long term. People would have short term jobs and longer term unemployment. The impact of high minimum wages would result in lower annual aggregate incomes for individual workers. (Wilson)

Some fairly recent developments have affected economies especially in the developed world: globalization and outsourcing. Businesses exist mainly to earn profits. With high minimum wages and corresponding high total costs and pricing, businesses can lose their competitiveness in the world market. They will have to find ways to cut costs—especially labor costs—to remain competitive in the world market. As a result, they resort to outsourcing. They transfer their production facilities to countries where labor costs are much lower. This action results in displacement of workers in the countries where the businesses originally came from. (Steidtmann)

While the overall macroeconomic picture may remain positive (Steidtmann), outsourcing can have negative effects on employment. However, outsourcing itself is not to blame. It is the high minimum wages set in some countries that is the cause of the problems as may be observed in the experience of some countries especially in Europe. Businesses have no choice but to keep their costs down by outsourcing. If these businesses fail, the entire economy might fail. The tradeoff is higher unemployment. Jobs are not available in Greece for instance because the factories have outsourced and moved out of the country. They cannot maintain operations in the country because of high legal minimum wages. (Weill)

Germany survived and even grew amid the Eurozone crisis. It has maintained its employment levels at pre-crisis levels. This seems to be the result mainly of one thing: low minimum wages. The German government before the onslaught of the crisis negotiated with labor sector to keep wages down or even reduce them. Labor cooperated. As a result, they were able to weather the world economic crisis better than most countries in Europe. (Stockhammer)

Conclusion

Minimum wages—or minimum wage hikes—are very popular and populist programs. Most people, especially those in the workforce, would welcome such developments. However, the arguments against them especially with regard unemployment and poverty alleviation seem to be stronger that those in favor of them.

There would be tradeoffs in such policy undertakings. There would be both economic and social costs. The best policy would be a balance between these two costs.

Minimum wage hikes may seem not to be the solution to the present economic problems in the world. However, some level of minimum wage—perhaps even lower than what is presently existing—may be the solution. It is important that businesses are kept alive. Wages should be maintained at a level that would allow companies to continue their operations and keep employing more people. They should remain competitive in the world. Otherwise, if companies fail, the entire economy could fail.

At the same time, workers need to remain employed, maintain their present standard of living, and be protected from abuse and exploitation. However, workers should at the same time realize that wage increases cannot be an option in during economic downturns. They should, as the Germans had, accept maintenance or even downgrading of wages for the collective benefit and protection of all workers.

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