Minimum wage

[Business](), [Employment]()

Unemployment particularly in South Africa is a serious matter that needs to be dealt with through investing a lot in education and training. It can be true that wage rate contribute to unemployment but this essay will discuss wage rate and explain how it could contribute to unemployment if it is below full employment. Thus it will define and discuss minimum wage as it is set above the equilibrium because above the equilibrium it is believed that it leads to unemployment. In explaining the minimum wage this essay will use a graph to illustrate impact of an imposed of a minimum wage. The advantages and disadvantages of minimum wage will be also discussed. Therefore it will conclude on whether minimum wage should be imposed or not and whether minimum wage is effective or not. Without any government interference in the market for labour, wage rate is determined where labour supply is equal to labour demand. This means that at a point of equilibrium within the market and the economy has reached it is full employment (Froyen, 2009: 43). " Wage rate is the price of labour that firms pay workers in terms of hours worked" (Froyen, 2009: 43). Therefore firms as profit maximizing will be willing to hire labour at a lower wage rate, meaning at a lower wage rate they will be willing to hire more workers in order to increase the firms' output. Firms prefer paying less wage rate for more working hours. If government does not intervene in the market with influencing wage rate, firms will take advantage to exploit workers by paying employees small amounts with longer working hours (Froyen, 2009: 44). Wage rate and its contribution to unemployment: People sell their labour in exchange for money which is in this case real wage (Slavin, 1989: 757). If firms can produce its target output without making any loss and households supply its labour without making any sacrifices then the market for labour is stable. Should firms decrease wage rate, then the problem will occur because the market is not balanced as the other side would be happy and another side would be unhappy (Slavin, 1989: 757). Lower wage rate discourages people from working and contributes to the unemployment rate. For labour supply, as the wage rate decreases then the quantity supplied of labour also decreases and vice versa (Slavin, 1989: 757). Lower wage rate decreases both output and employment. Wage rate can adjust in order to clear the market because the market forces are powerful in influencing the wage rate (Slavin, 1989: 758). Minimum wage: This is where government intervene in the market for labour. Government sets the minimum wage for sustainability. A minimum wage can be compared to a living wage and it is introduced by government so that workers may not be underpaid for the work they doing. A minimum wage is defined as a level of pay laid down by the law, for workers in general or some specific type (Black, and Myles, 1997). According to Black, Hashimzade and Myles, the intention of a minimum wage is to guarantee living standards for the low paid and to prevent exploitation of workers (Black, and Myles). However, a minimum wage could have potential disadvantages and advantages Disadvantages of a minimum wage: The disadvantage of a minimum wage is the fact that it contributes to unemployment because firms will be willing to hire only skilled labours. People who do not have skills that are required by firms will suffer in the labour market and the majority of youth in South Africa do not have skills (Stigler, 1946: 359). The effect of a minimum wage is the facts it requires highly skilled labour. Therefore if government decide to impose a minimum wage he should invest on education and training first. In the long run the minimum wage law hurts the people it is supposed to help like young worskers, the unskilled, and those whose productivity is low. Therefore the basic effect of the minim wage is to cause millions of marginal workers to be unemployed (Stigler, 1946: 359). Firms as profit maximizing will be mostly affected as they will discover a proportionately large increase in their wage bill. Therefore costs of production rise due to the increase in minimum wages, so it becomes expensive for firms to produce (Stigler, 1946: 360). A minimum wage contributes on reducing aggregate output because output depends on marginal product of labour. According to Stigler, a limitation of the minimum wage is the fact that it does not increase the incomes of the lowest incomes groups. Therefore less fortunate people do not benefit because they have to rely on government benefits and are therefore not affected by minimum wages (Stigler, 1946: 360). Many people who benefit from the minimum wage are second income earners and the household is unlikely to be below the poverty line. Also a minimum wage may increase the number of people working on the black market so firms can avoid paying the legal minimum (Stigler, 1946: 360). Advantages of a minimum wage: The advantage of a minimum wage will be that of it increases the wages of the lowest paid which will then have an increase income and reduce poverty (Burda and Wyplosz, 2013: 124). With reducing poverty that might not be true because this minimum wage only benefit people who are currently employed. Those who are unemployed will remain poor. The efficient wage theory states that “ higher wages can increase the incentive for people to work harder and thus higher wages may increase labour productivity" (Burda and Wyplosz, 2013: 124). This statement is true because workers will make sure that they keep their jobs by working hard and for productivity, people with skills are more productive than people who do not have skills, so labour productivity will increase. A minimum wage could increase the participation rate as the benefits of work become greater (Burda and Wyplosz, 2013: 124). Also firms will have an increase incentive to invest and increase labour productivity because labour is more costly. On the other hand if firms have monopoly power they can drive wages down by employing fewer workers (Burda and Wyplosz, 2013: 124). In a competitive market this could lead to black market because people will be desperate to work and end up selling their labour at a very cheaper price. However, minimum wages will make this more difficult. Therefore a minimum wage could have a positive effect on employment (Burda and Wyplosz, 2013: 124). The diagram below will show the effect of wage rate that is set above the equilibrium in the labour market. (Burda and Wyplosz, 2013: 124). The above diagram illustrates a minimum wage that is set above the initial equilibrium. It is a minimum wage restriction because firms cannot pay workers wage rate which is below the minimum wage (Froyen, 2009: 41). A minimum wage that is set above the equilibrium has no effect but below it has an effect, in fact in order for the minimum to be effective it should be above the equilibrium because its purpose is to reduce poverty and sustain people, mostly those who are working in critical conditions like farmers and mines (Froyen, 2009: 41). In the above diagram the wage rate has increased from W/P0 to W/P1 this increase has resulted to a decreased in quantity labour supplied from Q0 to Q1. At current minimum wage there is an excess supply of labour and that access supply, meaning the supply is greater than the demand (Froyen, 2009: 41). The imposed of a minimum wage create an imbalance to the labour market. As the quantity of labour supplied decreases, the output will also decrease because there now fewer workers who are producing goods and services. Therefore a minimum wage has an effect on increasing unemployment and decreasing output (Froyen, 2009: 41). To conclude, as the advantages and disadvantages of a minimum wage have been discussed above, the conclusion that can be drawn in comparing the two is that minimum wage is not efficient and it has negative outcomes. It does not necessarily reduce poverty as it supposed to but instead it creates imbalance to the labour market because some people who do not have skills end up losing their jobs. People get retrenched because it is a waste for the firms to pay a minimum wage for workers who are not trained for their job because hiring a labour is a cost to the business. Minimum wage leads to many economic instability because it increases unemployment, decreases output, and increases competition amongst workers. Minimum wage only benefits those who are currently working. Based on wage rate, a conclusion that can be made is the fact that lower wage rate discourages workers to work. A wage rate that is below equilibrium only attracts the demand for labour because for them it becomes cheaper to hire labour. Lower wage rate has an impact on increasing unemployment and decreasing output. This essay has covered both, the issue of wage rate and minimum wage and it has fully discussed on how these two factors contribute to unemployment