

Consequences of the increase in the Minimum Wage

Miguel Cardoso

Diario Expansión (Spain)

Every economic policy has intended and unintended consequences. The significant (8%) increase in Spain's legal minimum wage in 2017 will barely have any effect on employment or economic activity. Therefore in principle the measure's success will lie in the attainment of the objectives presumably pursued: improving the income of workers whose wages are tied to the minimum wage. However it will also have unintended consequences. Among these will be a reduction in demand for unskilled labour, which may affect groups, sectors and regions that are particularly vulnerable. What is more, if wage increases in excess of productivity gains spread to the rest of the economy, job creation may slow.

There are several theoretical reasons for supposing that the impact of the increase in the minimum wage may not have a significant effect on aggregate employment. Without going into all of them in detail, in the case of Spain we must highlight the fact that costs related to the minimum wage represent only a very small proportion of companies' total payroll bill. In particular, the minimum wage as a proportion of average income was one of the smallest in the European Union in 2016 (barely 35%). Furthermore, only 1.2% of non-farm workers were on the minimum wage, while the weight of these workers in the total payroll was barely 0.3%. The increase in the minimum wage will not cause these percentages to change much; for example the last two would increase to just 2.3% and 0.7% respectively, assuming the level of employment remained the same. Therefore, we expect the effect of this measure on employment and economic activity in 2017 to be insignificant.

However, there are nuances to this assertion. For example, there are people whose characteristics render them more likely to have a contract tied to the minimum wage. Therefore job creation may be adversely affected for these groups. In particular, each of the following conditions increases the likelihood of a worker's being on the minimum wage: being a woman, not having a university degree, having a temporary employment contract, being a part-time worker and having only a short period of service with the company. Apart from this, certain specific features of companies make them more inclined to use the minimum wage as a reference in recruiting. Among these we may mention location (much higher incidence in the Canary Islands), sector (transport, professional and artistic activities, education), the company's size and degree of internationalisation (the bigger it is and the more geared to external demand, the less likely workers are to be on the minimum wage), and if the worker is not covered by a collective labour agreement.

Apart from this, another nuance to bear in mind as regards the possible impact on employment of the increase in the minimum wage is its feeding through to other wages. At the moment, labour productivity is growing by around 0.4% a year. The increase in real remuneration should be fairly similar if job creation is to be maintained as a priority. For this it is necessary to remember that so far the recent increase in inflation has come not from any extraordinary increase in companies' margins, but mainly from higher prices of oil, an imported commodity. Alternative measurements of inflation, such as core inflation (excluding volatile components such as fuel), or the GDP deflator (which measures the prices of goods produced domestically) point to more moderate changes in prices, between 1.0 and 1.5%. Thus, job creation may be negatively affected both if companies decide to pass on much of their increased energy costs to consumers in order to maintain their margins (restricting the increase in household spending), and if wage demands are inconsistent with job creation, ignoring the fact that so far the beneficiaries of higher inflation operate abroad.

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