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I Z A
World of Labor
Evidence-based policy making

Do minimum wages stimulate productivity and growth?

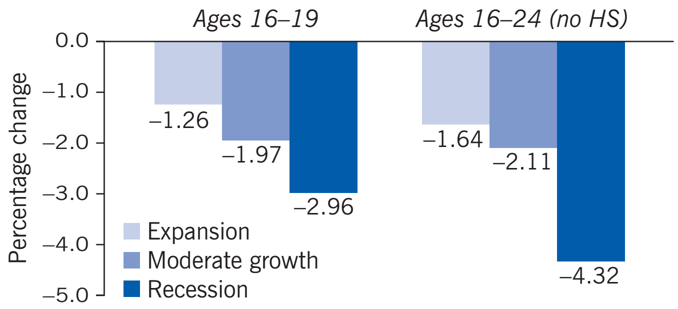
Minimum wage increases fail to stimulate growth and can have a negative impact on vulnerable workers during recessions

Keywords: minimum wages, business cycle, productivity, poverty

ELEVATOR PITCH

Proponents of minimum wage increases have argued that such hikes can serve as an engine of economic growth and assist low-skilled individuals during downturns in the business cycle. However, a review of the literature provides little empirical support for these claims. Minimum wage increases redistribute gross domestic product away from lower-skilled industries and toward higher-skilled industries and are largely ineffective in assisting the poor during both peaks and troughs in the business cycle. Minimum wage-induced reductions in employment are found to be larger during economic recessions.

Estimated effect of a 10% increase in minimum wage on low-skilled employment



Note: HS = high school diploma.

Source: [1].

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KEY FINDINGS

Pros

- Minimum wage increases are more likely to deliver income gains to low-skilled workers during peaks rather than troughs in the business cycle.
- Increases in the minimum wage may stimulate macroeconomic growth if productivity is shifted toward more highly-skilled sectors, possibly by inducing additional training for low-skilled workers.
- When increases in the minimum wage are indexed to inflation they do not appear to have larger adverse employment effects than non-indexed increases.

Cons

- Increases to the minimum wage redistribute the composition of industry-specific productivity in ways that harm some low-skilled workers rather than produce net economic growth.
- Minimum wage increases reduce employment more for less-skilled individuals during times of macroeconomic recessions as compared to expansions.
- Minimum wages are not well targeted to poor or near-poor individuals across the business cycle.
- Minimum wage increases are ineffective at reducing poverty during both business cycle peaks and troughs.

AUTHOR'S MAIN MESSAGE

Empirical evidence provides little support for claims that higher minimum wages will: (i) serve as an engine of economic growth by redistributing income to workers with a relatively high marginal propensity to consume; or (ii) alleviate poverty during economic downturns. Therefore, policymakers wishing to aid low-skilled workers during recessions, or to spur economic growth, should not look to the minimum wage as a policy solution. Rather, means-tested, pro-work cash assistance programs and negative income tax schemes can deliver income to the working poor far more efficiently.

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