

# Count the cost of higher minimum wage

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Setting the federal minimum wage is a balancing act. On the one hand, a higher minimum wage improves the living standards of thousands of working Australians. At the same time, raising the minimum wage may cost jobs.

To get the balance right, we need to know whether a higher minimum wage causes employment losses that are large, small or non-existent.

Much of the Australian debate over minimum wages has centred on findings from a controversial US study.

Comparing employment rates in New Jersey and Pennsylvania after a 1992 rise in the New Jersey minimum wage, economists David Card and Alan Krueger found that there the minimum wage rise had zero impact on low-wage workers.

Even those who criticise this study tend to agree that the employment cost of boosting the US minimum wage is fairly small.

Most US labour economists believe that a 1 per cent rise in the minimum wage would decrease employment by between zero and 0.25 per cent.

Given that Australian minimum wages are higher (compared with median earnings) than US minimum

wages, translating this research into the Australian context is not straightforward.

In recent years, the Australian Industrial Relations Commission has borne witness in its annual minimum wage case to polarised arguments from both sides.

While the Australian Council of Trade Unions contends that raising the minimum wage has zero effect on unemployment, employer groups and the federal government argue that the cost could be much higher, citing a 1998 Productivity Commission study that found that a 1 per cent rise in the minimum wage causes youth employment to fall by up to 5 percentage points (a figure so high as to be scarcely believable).

In an effort to more precisely estimate the employment effect of Australian minimum wages, I adopted an approach similar to Card and Krueger, exploiting what is known as a "natural experiment".

While minimum wages in most states move in concert, Western Australia under the Liberal government of Richard Court was unique in setting its own statutory minimum wage, meaning that increases in the WA statutory minimum wage did not coincide with increases in the rest of Australia. In

experimental terms, WA was the "treatment" group, while the rest of the nation served as the "control".

This allowed the question: do we see a difference in employment rates between WA and the rest of Australia when WA raises its minimum wage? Aggregating the results from six increases in the minimum wage, it appeared that a 1 per cent rise in the WA statutory minimum wage was associated with a 0.13 percentage point fall in employment.

This suggests that the employment effects of Australian minimum

## **"The rise had zero impact on low-wage workers."**

wages are around the midpoint of estimates for the US.

Though some may be disappointed to discover that the employment cost of raising the minimum wage is not zero, they should instead be heartened to learn that the cost is relatively low.

These findings indicate that modest increases are not likely to cause significant employment losses.

What does this mean for both sides' claims in the 2004 minimum wage case? While the ACTU is calling for a 6 per cent increase in

the federal wage floor, the federal government is likely (based on its submissions in recent years) to call for about a 2 to 3 per cent rise.

My findings suggest the ACTU's claim would result in a 0.8 percentage point fall in employment, while the government's would cause a 0.3 percentage point drop.

Only half a percentage point separates the employment effect of the two claims — a relatively small amount, given that the employment rate often moves by this amount from one month to the next due to seasonal variation.

The employment costs of raising the minimum wage appear relatively small, while the chance to provide a boost to the incomes of the working poor is real.

The evidence from the West Australian minimum wage experiment appears to provide support for regular, moderate increases in the federal minimum wage.

■ *Andrew Leigh is a PhD student at the John F. Kennedy School of Government, Harvard University. His paper "Employment Effects of Minimum Wages: Evidence from a Quasi-Experiment" appeared in The Australian Economic Review, December 2003.*