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## On the Peculiar Relevance of a Fundamental Dilemma of Minimum-Wage Regulation in Post-Socialism - Apropos of an International Investigation

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On the Peculiar Relevance of a Fundamental Dilemma of Minimum-Wage  
Regulation in Post-Socialism – Apropos of an International Investigation

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# **On the Peculiar Relevance of a Fundamental Dilemma of Minimum-Wage Regulation in Post-Socialism – Apropos of an International Investigation**

István Gábor R.

## Abstract

To the extent minimum-wage regulation is effective in fighting against excessive earnings handicaps of those at the bottom of earnings distribution, it may have the side-effect of worsening their employment prospects. A demand-and-supply interpretation of data on the relative employment rate and earnings position of the least educated in the EU27 suggests that the resulting dilemma might be particularly relevant for minimum-wage policies in post-socialist countries.

JEL: J21, J23, J31 J38, J71

**Keywords:** minimum wage, employment, earnings dispersion, demand and supply of labour, wage and employment discrimination

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This short essay was prepared and presented as a contribution to the conclusive panel of the Conference on „Minimum wage systems and changing industrial relations in Europe” (Brussel, September 23-24, 2010), organized by Manchester Business School in cooperation with the European Commission. For summaries of country case-studies (on Croatia, Germany, Hungary, Spain and the UK) and of their comparative evaluation that were discussed there, see:

<http://www.mbs.ac.uk/research/europeanemployment/projects/minimum-wage.aspx>.

The author owes thanks to Zsombor Cseres-Gergely, János Köllő and David Stark for their empathic reading and inspiring comments.

# **A minimálbér-szabályozás alapdilemmájának különös jelentőségéről a poszt-szocializmusban – egy nemzetközi vizsgálat apropóján**

Gábor R. István

## Összefoglaló

A minimálbér-szabályozás, amennyiben eredményes a kereseteloszlás alján lévők túlzott kereseti hátránya elleni küzdelemben, mellékhatásként foglalkoztatási kilátásaik romlását idézheti elő. A legkevésbé iskolázottak viszonylagos foglalkoztatási rátájára és kereseti pozíciójára vonatkozó EU27-adatok kereslet-kínálati értelmezése azt sugallja, hogy az ebből fakadó dilemma különös jelentőségű lehet a poszt-szocialista régió országainak minimálbér-politikája számára.

Tárgyszavak: minimálbér, keresetszóródás, munkaerő-kereslet és -kínálat, bér- és foglalkoztatási diszkrimináció

JEL: J21, J23, J31 J38, J71

## 1. THE DILEMMA

Minimum-wage regulation is a notoriously controversial issue among economists. So much so that about any pro invites a con, with periodic shifts in emphasis.

Were one professing, for instance, that minimum-wage regulation may serve well as a helping hand for those who are at the lower tail-end of the earnings distribution for lack of bargaining strength, someone else would readily bring up some market-distortion kind of counter-argument. Say, that minimum-wage regulation, by hurting nonunion cost and price competition to union firms, tends to strengthen even further the excessive bargaining power of those employed at union firms.

Advocates of minimum-wage regulation as a policy tool in fighting against poverty would meet particularly vehement opposition. It is far too blunt an instrument, someone would immediately riposte, pointing to the high proportion of those at the bottom of the earnings distribution who are by no means poor. If still deployed, the riposte would go on, it may backfire (as it clearly did in Hungary, as shown by findings, reported by Köllő (2010), of studies of the impacts of the 2001-2002 minimum wage hike): it may worsen the chance of entering into and/or remaining in gainful employment for exactly those who are meant to be helped.

How far is this latter sort of counter-argument, and the dilemma of minimum-wage regulation policy it implies, well-founded is not the issue I am going to discuss. What I want to demonstrate is that, to the extent there is any truth in it – and few would doubt that there is some –, it must be particularly relevant for post-socialist countries, including my home country (Hungary).

Were I right in that, an obvious corollary would be that lessons drawn from the experience of minimum-wage regulation in mature capitalist countries may not automatically/invariably apply to their post-socialist counterparts.

## **2. THE APPROACH**

I was lucky enough to be an invited fellow at Collegium Budapest Institute for Advanced Study when, in late 1994, Nobel Laureate Robert Solow delivered a lecture there on how simple tools of demand-and-supply analysis could help explain the tendency of increasing earnings inequalities, as measured by the proportion of low-earners (earning below 2/3 of median) and various ratios of earnings deciles, that had been observed in the United States from 1975 to 1989. My contribution will, too, be based on a demand-and-supply kind of interpretation of similar indicators.

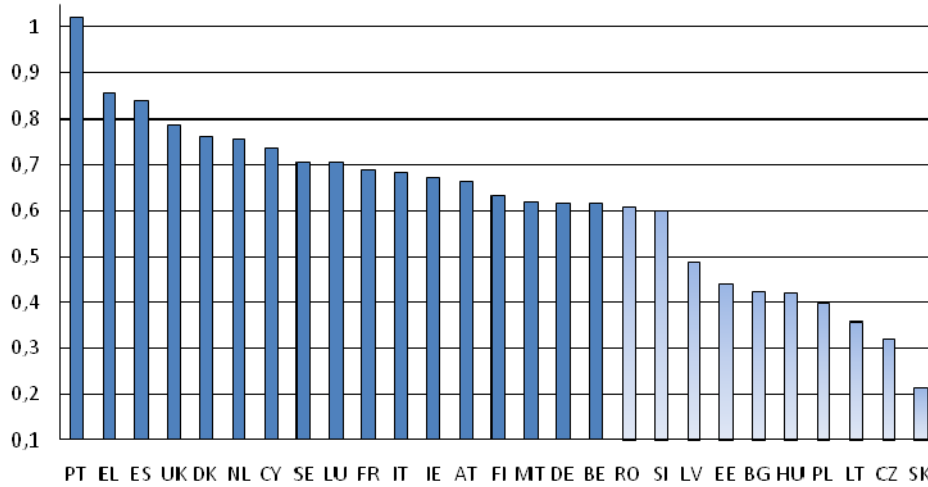
At the same time, instead of trend-like evolution that may or may not be common to several countries, my contribution will address apparent distinctness of post-socialist vs. mature capitalist member-countries of EU27, as is attested by figures calculated from EUROSTAT employment data and OECD earnings data for the year 2006.

Furthermore, my exposition will mirror-image Solow's in that, while he started out from data on earnings dispersion, and turned to data on unequal chances of employment only as a second step, I will follow the opposite route. The reason for this is purely pragmatic. It is motivated by today's convention of setting goals in terms of employment opportunities rather than of earnings dispersion, at domestic as well as international forums.

## **3. THE FACTS**

As is immediately apparent from the inspection of *Figure 1*, post-socialist member-countries of EU27 consistently lag behind the mature capitalist group with respect to the ratio of the employment rate of the least educated – those with lower secondary education or less – to the rate of employment of those with upper secondary education. Ranked according to this ratio, post-socialist countries, with no exception, are placed as file-closers.

*Figure 1*  
**Ratio of the rate of employment of those with lower secondary education or less to that of those with upper secondary education within the 25-64-year-old population in the EU27\***

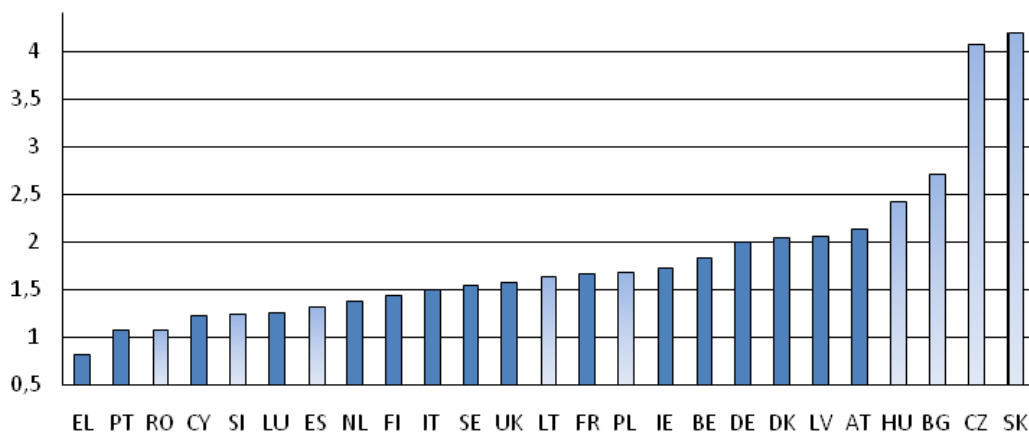


\*Member-countries in alphabetical order (with their abbreviations in brackets): Austria (AT), Belgium (BE), Bulgaria (BG), Cyprus (CY), Czech Republic (CZ), Denmark (DK), Estonia (EE), Finland (FI), France (FR), Germany (DE), Greece (EL), Hungary (HU), Ireland (IE), Italy (IT), Latvia (LV), Lithuania (LT), Luxemburg (LU), Malta (MT), Netherlands (NL), Poland (PL), Portugal (PT), Romania (RO), Slovakia (SK), Slovenia (SI), Spain (ES), Sweden (SE), United Kingdom (UK).

*Sources of data:* <http://epp.eurostat.ec.europa.eu/portal/page/portal/eurostat/home>

In seeking to identify the origin of their lagging behind in a supply-and-demand framework, one might hope to get some clue from ranking the same countries according to their analogously-defined relative unemployment rates, as is illustrated by *Figure 2*. This additional ranking, however, is of not much guidance.

*Figure 2*  
**Ratio of the rate of unemployment of those with lower secondary education or less to that of those with upper secondary education within the 25-64-year-old population (without Estonia and Malta, for lack of data on education-specific unemployment)**



*Sources of data:* see at *Figure 1*.



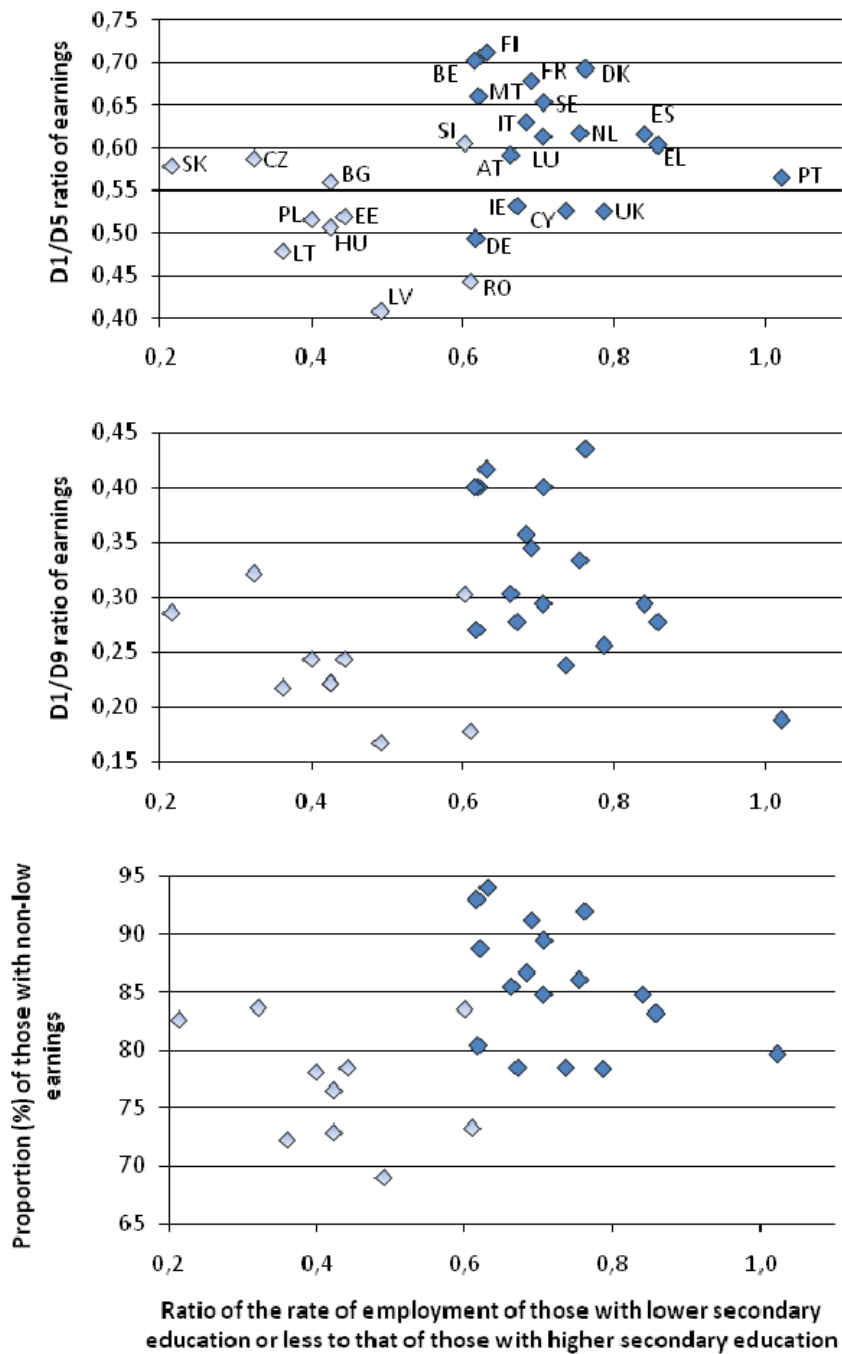
True, it does not yield nearly as unambiguously distinct, complementary patterns of positions of the respective country-groups as did our previous ranking. Nevertheless, it does not follow that supply-side factors are to be blamed in the first place.

To wit, supply and demand are – unlike our ratios of relative (un)employment rates – not scalars, simply measurable as (derivatives of) physical quantities on a one-dimensional scale. They are, instead, conventionally conceived as sets of vectors of some kind of physical quantities and corresponding prices, and, therefore, they can only be illustrated in a meaningful way in a two-dimensional, price-quantity space.

In *Figure 3*, accordingly, relative employment rate of the least educated of each country is plotted against some tightly correlated (imperfect) measures of the size of the least-educated/more-educated earnings gap – representing reasonable alternative approximations of the price ratio of least educated/more educated labor –, which, in turn, are, as a matter of fact, strongly influenced by the level of the minimum wage (as is demonstrated by Grimshaw [2010] in his comparative report, where a negative cross-country relationship, with  $R^2=0.59$ , is reported between the minimum wage/average earnings ratio and the proportion of low-earners).

Figure 3

Earnings inequality among full-time employees and the relative rate of employment of the lowest educated



Sources of data:

<http://epp.eurostat.ec.europa.eu/portal/page/portal/eurostat/home>  
for employment

and

<http://stats.oecd.org/Index.aspx>  
for earnings dispersion figures.

Interpreting the resulted plots in supply-and-demand notions, reasoning may go like this: To the extent consistently lower relative employment rates of the least educated in the post-socialist region were due to lower relative supply of labor among the least educated population of working age (which could result from, e.g., generous income support for the low-income non-employed), better earnings positions of the low-educated, and narrower earnings differentials thereby, should simultaneously be observed there – just the contrary to what *Figure 3* attests.

What we see is that under post-socialist conditions the least educated are doubly disadvantaged in the labour market as compared to their peers in the mature capitalist world: they are hit by both consistently lower rates of employment and lower relative earnings – an unambiguous syndrome of lower relative demand for their labor.

#### **4. CAUSES AND CONSEQUENCES**

What aspects of post-socialist capitalism should be blamed for this lower relative demand? It is beyond me to present the answer. But generalizing from findings of János Köllő's studies of the Hungarian case, the following three aspects of post-socialist evolution come to mind as the most obvious immediate causes: (1) an exaggeratedly fast rate of education-biased technological development, relative to the evolution of educational composition of the working-age population; (2) widening gap between the least educated and the more educated in marketable competencies and skills; and/or (3) a relative abundance of formally skilled labor with obsolete skills at the initial stage of post-socialist transition, with a resulting marked inflow of formally skilled labour into elementary occupations, which gave rise to a tendency of hiring over-qualified job applicants for such occupations.

More relevant to the main thrust of my contribution than getting deeper into the causes is to complete the list of consequences. In addition to the lower relative rates of employment, coupled with lower relative earnings, of the least schooled, one more twin consequence needs to be spelled out. Namely, that lower relative demand for this category of labor provides a fertile ground for the proliferation of discrimination, be it prejudice-induced or statistical, while biasing its form of manifestation from wage discrimination as a relatively innocuous form towards employment discrimination as a more blatant and socially more destructive form.

## 5. CONCLUSIONS

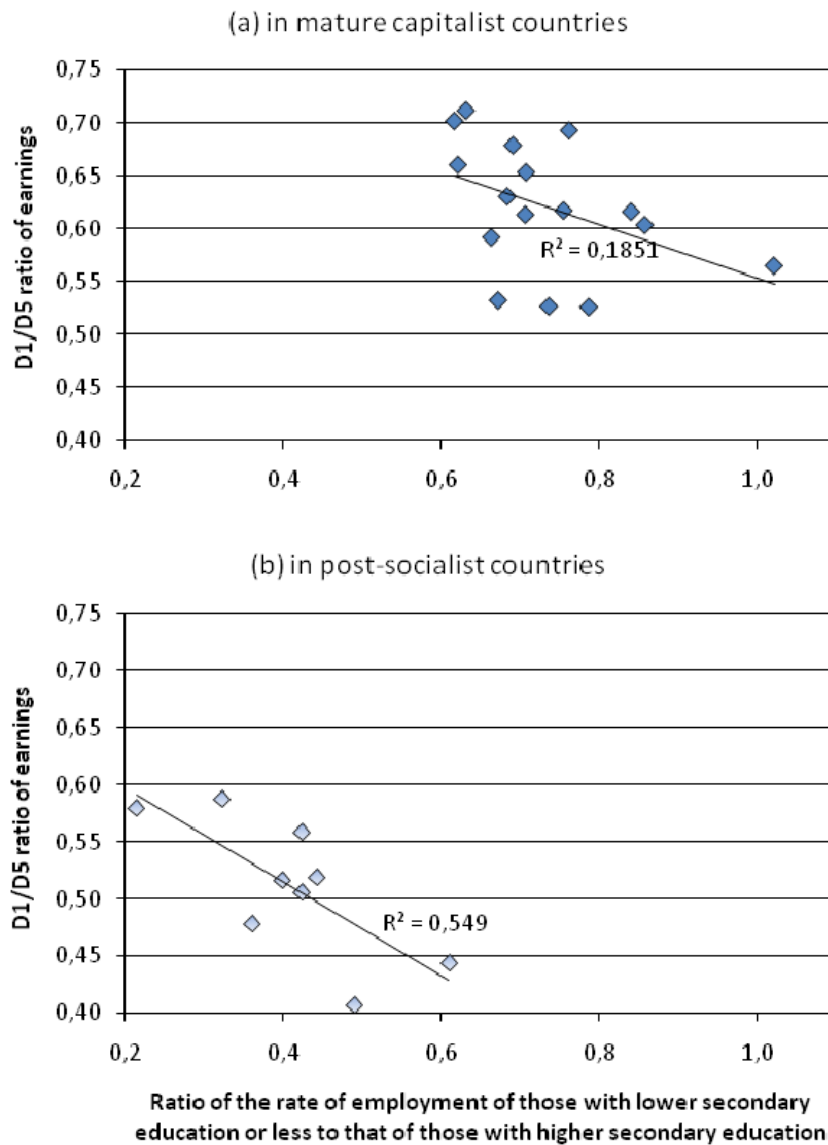
Let us take one more look at our upper diagram in *Figure 3* – or, better, at its variant in *Figure 4*, where data points of the two groups of countries are put in separate graphs, and regression lines, conceived as representations of some kind of country-group level quasi-demand functions, are fitted to the data points of the respective groups.

From among our three measures of earnings dispersion only data on the D1/D5 ratio are exploited here, for the obvious reason of this indicator being most closely related to the earnings ratio of those with lower secondary education or less to those with upper secondary education. (Nothing qualitatively different would have emerged from the other two proxies, anyway.) Besides, Germany, for not being either mature capitalist or post-socialist in its entirety, is dropped, and so is Slovenia as an outlier according to several more economic indicators than just the ones of our interest here. Country markings are omitted, for better visual transparency.

The *Figure* speaks for itself. The seemingly inferior (i.e. closer-to-the-origin) position of the post-socialist quasi-demand curve, while it implies more acute need for minimum-wage regulation, given the more disadvantaged earnings position of the least educated, also implies more acute danger of its employment kickback, given their lower relative rate of employment. Under the conditions of post-socialism, moreover, relative earnings and employment of the least educated are seemingly much more tightly correlated (cf. the respective values of R-squared in the *Figure*), i.e., inevitability of painful trade-offs must be far more obvious. Accordingly, considerably more stringent restraint is warranted in improving the earnings position of the lowest paid via minimum-wage regulation.

Similarly more conflict-loaded in the post-socialist region must be the impact of minimum-wage regulation on discrimination. Greater earnings handicaps, arising from the generally wider dispersion of earnings, of those from among the lowest schooled who are discriminated against is a telling argument for the deployment of minimum-wage regulation. No less telling is, on the other hand, the counter-argument which warns that, to the extent minimum-wage regulation does in effect reduce wage discrimination, it may induce higher incidence of employment discrimination: the creaming off of workers in elementary occupations who either belong to more favored groups or are over-qualified for the jobs – employers' practices that hurt the least educated the most. For this reason, again, more moderation is appropriate in setting minimum wage targets in this region.

*Figure 4*  
**Earnings inequality among full-time employees and the  
relative rate of employment of the least educated**



*Sources of data: see at Figure 3.*

To sum up, under the conditions of post-socialist capitalism, as it stands, systematically lower relative demand for the least educated category of labour does, indeed, seem to make the fundamental dilemma of minimum-wage regulation distinctly more conflict-loaded and, thus, particularly relevant – with differential impacts on the evolution of post-socialist minimum wage systems and industrial relations yet to be discovered by future research.

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