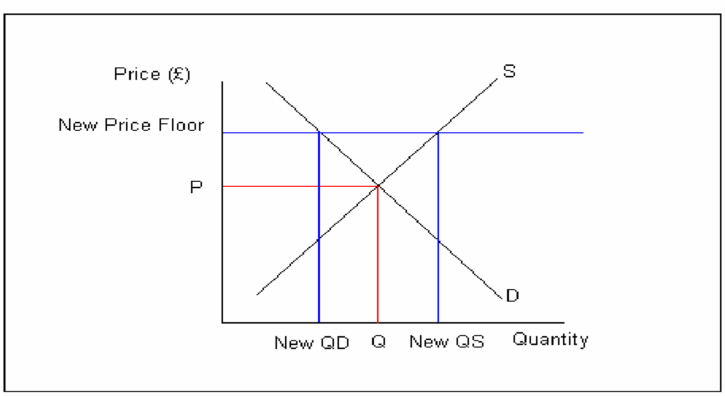
"Suppose a government wishes to raise incomes of the working poor. It suggests the raising of the minimum wage. Use the demand and supply framework to evaluate the effect on the wage for unskilled workers, and the numbers of workers in employment and the n umbers on the unemployment register. Discuss how demand and supply elasticities may effect these changes, both in the long run and short run. In the light of your discussions, do you believe the policy can be effective in meeting the Government's goal?"

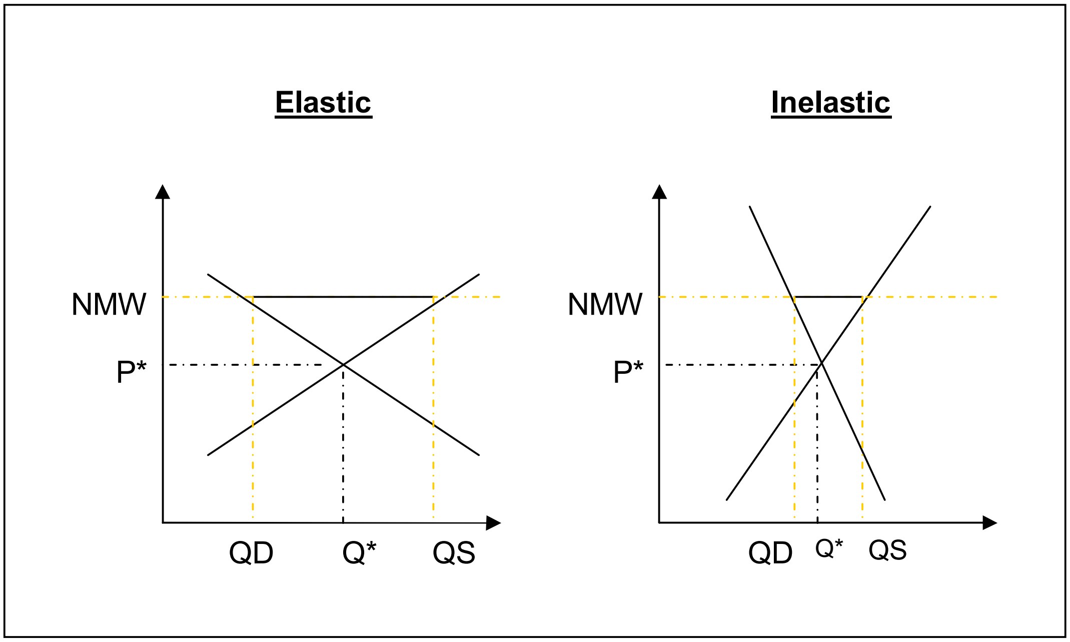
The constant invention and implementation of labour -saving technology is the principal reason why demand for certain types of labour is constantly reducing (Parkin, 1995). The main type of labour that suffers is unskilled work. This includes such jobs as cleaning, security or factory work. As there are simply less jobs available for unskilled labourers, increasing numbers turn to the unemployment register to provide income. A second consequence of the ever –increasing mechanisation and subsequent fall in dem and for unskilled labourers is that the wages of these jobs decrease. This fall in wages can increase poverty and worsen the standard of living for those still in unskilled work. In order t o combat these effects, the government has the option of introducin g legislation making it illegal for employers to pay wages that are below a certain level. In the UK, a National Minimum Wage (NMW) was introduced in April 1999. It stated that full-time workers aged 22 and above should be paid a minimum of £3.60 per hour and those aged below 22 should receive £3.00. This was increased in October 2001 to £4.20 for over 22 and £3.60 for those under that age (Simpson, 2003). This signalled the UK joining other countries such as Australia, America, Japan and many European nations in setting a minimu m wage (Low Pay Commission, 2000). Since this policy was introduced, the numbers of people in jobs paid below minimum wage has dropped from 6% of the UK workforce in April 1998, to just 1.3% in April 2002 (National Statistics Online, 2002). However, the overall levels of unemployment have increased from 4.2% (Birmingham Unemployment Briefing, 1999) to 5.1% between 1999 and 2003 (National Statistics Online, 2003). This implies that introducing a National Minimum Wage induces a trade -off between an increase in wages and consequent improvement in standard of life and an increase in national unemployment. It also suggests that there are fewer jobs available at these higher wages. To back up this hypothesis, we can look at the implications of the new legislation in terms of demand and supply and their respective elasticities both in the short and long term. Other factors that could have a bearing on the success of the new policy will also have to be examined.

It is important to understand that imposing a minimum wage on the labour market represents a price floor.



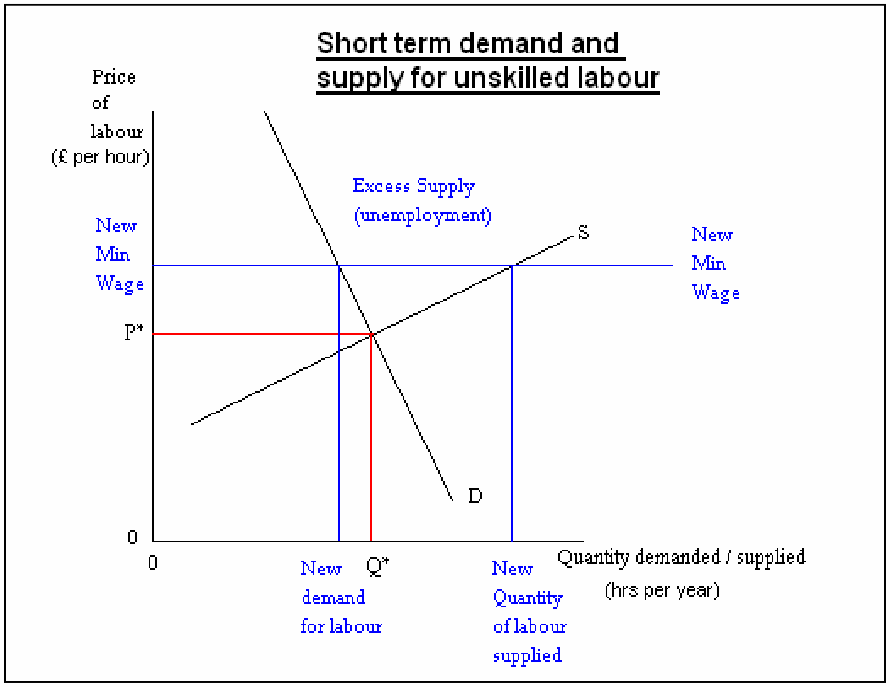
A price floor is a minimum price that has to be paid for a good or service. In this question, the good involved is unskilled labour and the price is the minimum level of wages the company must pay. It is clear that if the price floor is imposed above the equilibrium position, demand will fall as price will be higher, and suppliers will be willing to supply additional quantities as they will receive a larger price per unit.

When a minimum wage is introduced, an excess supply will be created. This is in the form of unemployment. The exact amount of this unemployment will vary greatly depending on the elasticities of demand and supply for unskilled labour (Bized.ac.uk, 2003), as shown in the next diagram.



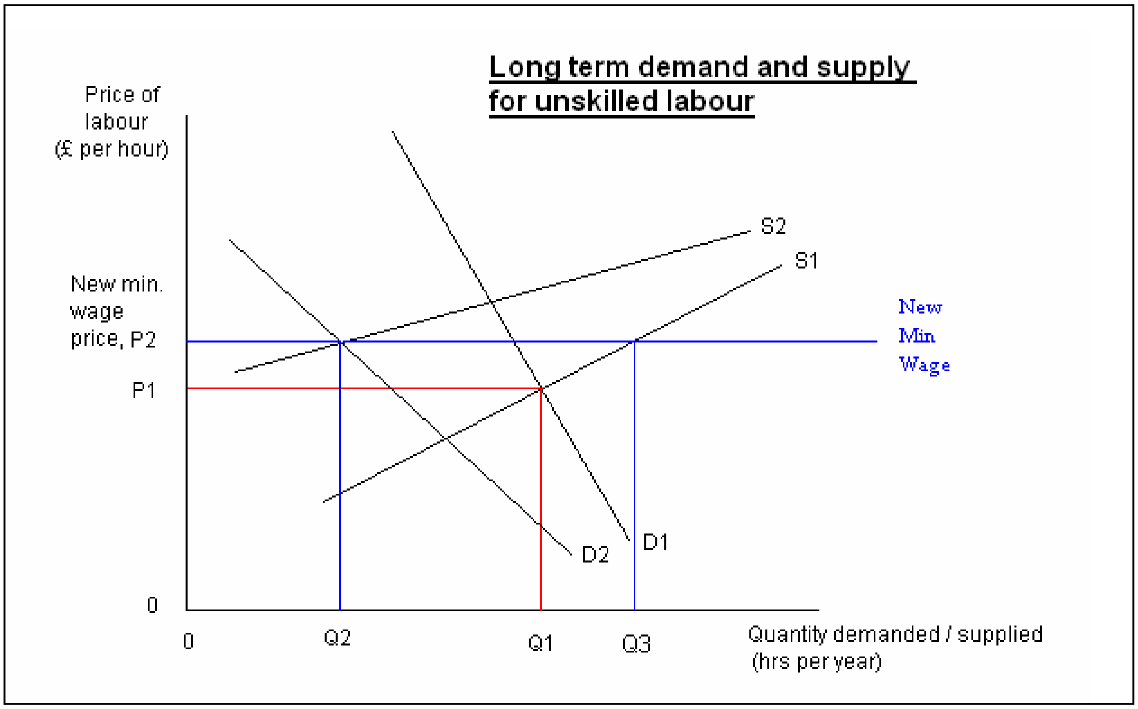
From these diagrams, we can see that if demand and supply for unskilled labour was relatively inelastic, then unemployment created would be a lot less than if they were more elastic.

The next diagram represents the demand and supply for unskilled labour at the time of the introduction of the minimum wage (the short term , where all other factors remain constant).From the diagram we can tell that the demand and supply curves have different elasticities . Demand is fairly inelastic. This is because the jobs available will involve necessary tasks and there will be no other alternative to labour available at this time (Bized.ac.uk, 2003). The supply curve however is fairly elastic. This is due to the fact that the jobs are unskilled and consequently there is a large pool of labour competing for each job. It is also true that a small increase in wage will tempt many of the unemployed back into work.



We can see that the equilibrium price for unskilled labour before the NMW comes into affect is P* and equilibrium quantity demanded and supplied is Q*. However, once the NMW is introduced (or increased, assuming a previous equilibrium position has been reached) companies will demand less labour as they cann ot afford the increased costs. Supply is also greater at this new level, as more unskilled labourers are willing to work for a higher wage. Unemployment created is simply the difference between the new quantity of labour supplied and the new quantity deman ded. So what will happen to all of the unskilled labourers who are made redundant as a result of the minimum wage? Their main options w ould be to either start claiming unemployment benefit or try and get back to work either in an unskilled job, or to aim for a skilled job and do extra training in order to increase chances of getting into a highly paid, skilled profession. In skilled jobs, the wages will be much higher and therefore will not be affected by the introduction of the minimum wage. Companies will also be forced into action as a result of the new legislation. They will not be able to afford the same amount of labour hours and therefore will attempt to find and implement new technologies as a replacement for human workers. This leads on to what will happen in the long term.

A major factor influencing a company's long term elasticity for labour is "the substitutability of capital for labour" (Parkin, 199 5; 385). This is saying that as time goes on, new technologies will be invented, and the easier it is to replace labour with these machines in a specific production environment, the more elastic demand for labour in that specific company will be. This is a particularly relevant statement when applied to unskilled labour. Much unskilled work is on produ ction lines where new technologies, for example robotics, are being widely used. This represents a cheap substitute for labour and for this reason, demand for labour will be more elastic as more financially efficient alternatives are available.



In terms of supply, many workers will have opted to gain extra training and qualifications in hope of securing a highly paid job in the skilled labour market. It is also true that as more and more time goes on, young people will not enter the unskilled market as it will become evident that there are not enough jobs to go around. They could stay at school longer or do modern apprenticeships, for example. These factors will result in a decrease in the number of workers in the unskilled labour market, including those without jobs. The decrease will be the difference between Q2 and Q3 in the diagram above (although the exact amount will depend on the exact elasticity of supply of labour). The overriding short term effect of introducing or raising a minimum wage will b e increased unemployment and an increase in numbers claiming unemployment benefit. However, in the long term, a proportion of these unemployed will go on to gain extra skills and will enter the skilled labour market. Therefore it is hoped that the initial increase in unemployment and poverty for the workers who lose their jobs will subside over time.

There are also other potential effects of setting a higher minimum wage. It could cause a wage -price spiral where an increase in wages leads to an increase in real spending power and higher demand for goods. This pushes prices up and causes inflation in the long run. It may also lead to worker unrest; the workers not affected by the new minimum wage may press for pay increases if it seems that everyone else in the company is getting one.

Using a minimum wage is only part of the government's arsenal to fight poverty. New pay standards will have to be accompanied by other working incentives such as tax breaks for the lowest earners, evident in the USA; or the Wor king Families Tax Credit (WFTC) introduced recently in the UK (Tran, M, 2000).

In answer to the question, I believe that this policy can be effective in raising incomes of the working poor, but only as part of a larger strategy. I would recommend accompanying minimum wages with other incentives to work such as tax credits and family benefits for working parents. They could also limit the amount of time that someone can claim unemployment benefit in order to force them back into work. In order to decrease the inevitable unemployment which will arise after the new wage standards are set, the government should introduce new training schemes to help people get back into work with new skills so that poverty can be avoided. The new level at which the minimum wage is set will have to be calculated very carefully so that it limits the creation of unemployment by not being too high for companies to pay.

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