What are the economic impacts of minimum wage laws on employment and business profitability?

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Introduction

The economic impacts of minimum wage regulations on employment and business profitability have been long debated. While minimum wages aim to increase the standard of living of low-income individuals, it is argued that these minimum wage regulations could lead to an increase in unemployment as firms try to control rising labor expenses in order to prevent eroding profit margins. Thus, total employment levels may be impacted, especially in sectors of the economy with narrow profit margins. It is crucial to examine the relationship between these variables in order to maintain sustainable businesses and gain insights into regulating the labor market for a strong economy.

Over the years, several arguments have been about the effects of minimum wage regulations. Until the early 1990s, the majority of empirical studies agreed that the minimum wage had a negative effect on employment. However, since 1992, David Card and Alan Krueger challenged the conventional wisdom in labor economics, providing evidence that a decrease in the employment level does not necessarily accompany the increase in minimum wages. In addition, the Organization for Economic Co-operation and Development (OECD) is in favor of minimum wage; however, in recent analyses, it has been recommended that minimum wages should increase at a lower rate than the average wage to create better chances for low-wage workers.

Additionally, there are several economic theories related to wage setting. According to the Keynesian approach, the effects of an increase in minimum wage cannot determine the impact on employment. As is the case with commodity prices, an increase in wages will increase the labor costs and is expected to cause an increase in product prices, while a decrease in wages is expected to result in a decrease in prices.
To sum it up, the Keynesian approach assumes that introducing a minimum wage is expected to exert some upward pressure on the price of products, while its effect on employment is unspecified in advance.
Meanwhile, the “orthodox” Neoclassical approach considers the minimum wage as an element that distorts the balanced function of the labor market by increasing the initially low wages beyond the equilibrium. This approach considers the minimum wage to cause unemployment. There are also several labor market theories. For example, the assumption of monopsony, where employers have greater power and control in the market, in which the employers collude with each other and exploit the imperfect information and other personal weaknesses of low wages. In a monopsony labor market, there is underemployment. This model concludes that the minimum wage reduces employment. Furthermore, In the simple supply and demand model, initial employment is determined by supply and demand, once the minimum wage is introduced, employment falls. The proportion reduction in employment is equal to the proportional wage increase times the elasticity of demand. In the Search-and-Matching Models, a minimum wage can lead to an increase in the level of employment because it increases the probability that some

workers will receive a wage offer that exceeds their reservation wage and because it induces firms already paying above the minimum to raise their wage offers as well. Ultimately, we suggest that there is an insignificant effect of minimum wages on employment, with a few exceptions. However, further light needs to be shed on this issue.

Economic Theories Related to Wage Setting

FULL WAGE – PRICE FLEXIBILITY (CLASSICAL CASE)

According to classical economists, **money wage is not constant**. Rather, the balance between demand and supply of labour simultaneously determines the real wage and the level of employment in the economy.

Because of diminishing marginal returns, the demand for labour is inversely related to the real wage. The supply of labour, on the other hand. depends positively on the real wage. Labour creates disutility because it involves the sacrifice of leisure, which is a source of utility. But work has a positive side too. Through it, one earns income that can be used to purchase goods and services for consumption. The optimum supply of labour (hours of work) is determined by balancing the disutility of work with the real return from work. Once again, it is the real wage that matters, not the nominal wage. Suppose that, initially, w = INR 50 per hour and P = INR 2, implying a real wage of 25 units of the product. By working one hour, a person gets INR 50 with which he can purchase 25 units of the commodity. If now w increases to INR 100 per hour and at the same time P rises to INR 4, the real wage does thot change and the person can obtain only the same amount of consumption goods (25 units) as before for an hour's work in spite of the rise in w. So, he will not change his labour supply. If, instead, P had remained unchanged following the rise in w, the real wage would have increased to 50 units of the product, making work more attractive (leisure costlier) and calling forth more hours of work. Thus, the labour supply of a rational person who derives utility from consumption and leisure will be positively related to real wage.

Shift in Labour Supply

A tax on labour income discourages work effort by transferring a part of the real wage from workers to the government. So, a reduction in such taxation calls forth more supply of labour. The supply curve shifts to the right. A change in taste and preference of the households with respect to participation in the labour market will cause the labour supply to change. Below figure brings labour demand and supply together to depict balance in the market for labour.

The equilibrium levels of real wage and employment are (w/P)* and Lf respectively. Since the demand and supply of L are equal at this value, Lf is called the full employment level. Everybody looking for work can find work at (w/P)*. Employment will be continuously maintained at this level through flexibility in w and P.

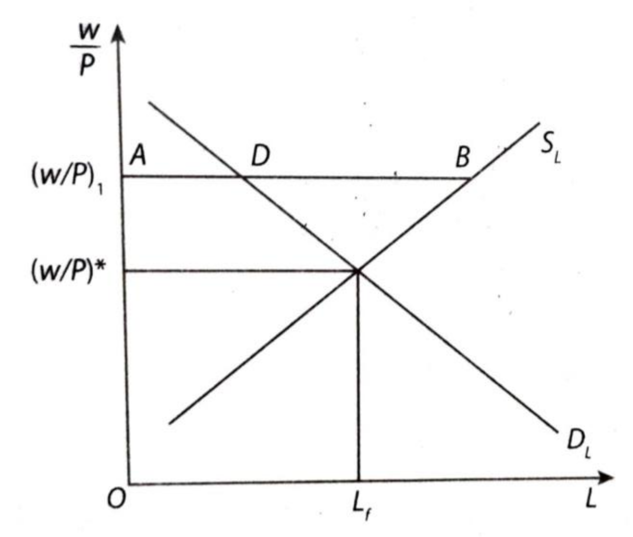


Figure 1: Labour Market Equilibrium

Suppose for some reason, the prevailing real wage is at (w/P)1 > (w/P)*. The result is unemployment. (Supply of labour = AB exceeds demand = AD) But this disequilibrium will be eliminated by a fall in w/P brought about by the pressure of unemployment. As the real wage falls, the demand will improve and the supply shrink and the gap will be closed and full employment restored at point E. According to this view of a frictionless labour market adjustment, persistent unemployment is an impossibility unless some factors (such as minimum wage laws or trade union resistance) hold up the required downward adjustment in w/P.

WAGE AND PRICE RIGIDITY (KEYNESIAN)

The polar opposite to the classical approach is the supposition by Keynes that, at low levels of output and employment, P (as well as w) can be taken to be constant. The modern-day followers of Keynes, called new Keynesians, have advanced sophisticated arguments to defend the assumption of non-flexible wages and prices. The two most important ones-efficiency wages and menu costs are discussed below.

1. Efficiency Wage Hypothesis

Keynes believed that the money wage would not adjust quickly enough in the short run to preserve full employment all the time. Wage contracts between employers and workers are usually made in terms of the money wage and, once made, stay in effect for a number of years. They are not subject to continuous revision in response to changing prices or pressures of labour demand or supply.

New Keynesians claim that there are additional reasons why the firms, who are assumed to have the power to fix wages, may set the real wage at a level higher than the market clearing value (w/P)* of Figure 1. A high real wage and unemployment will be simultaneously present in equilibrium.

The chief explanation is in terms of the efficiency wage theory which implies that it may be in the best interest of firms to offer a high real wage. There are several reasons why firms may decide to do so. Labour turnover is costly to a firm. Every time an existing worker quits, the firm has to incur expenditure to recruit a new one and retrain him for the job. If a high wage is paid, fewer workers quit and firms minimize turnover costs. Moreover, a labour force that is well paid is motivated to work more productively in return for the 'fair treatment' offered by the employer and this adds to the firm's profits. Also, by offering high remuneration a company raises the cost of losing the job and this is expected to deter shirking on the job. The fear of unemployment act as a disciplining device.

To summarize, a real wage that is higher than the market clearing led enables a firm to build up a more experienced and more efficient labour force. Being the outcome of deliberate choice by firms, it ceases to be a variable that moves up and down to keep the economy always at full employment.

2. Menu Cost Hypothesis

When a restaurant wants to change the prices of its offerings, it has to incur the expenditure of printing a new menu card. This is the origin of the term menu cost of price change. These costs are usually small, but a firm may choose not to change the price if the lost profit from doing so is smaller than the (small) cost of changing the price. Whether this will be the case depends crucially on the nature of market competition.

In a perfectly competitive market, the elasticity of demand facing individual seller (who constitutes a tiny part of the total market) is very high. Even a very small deviation from the going market price, which is beyond control, will cause large swings in sales and, hence, in profits. The cost of net hitting the right price is very high and it will certainly outweigh any small menu cost. So, a competitive firm will always adjust its price in response changing conditions of cost or demand.

However, the situation is different for a seller who has a monopoly power in the market. The demand for his product responds much less sharp changes in price and, the loss in profit, from mispricing, is corresponding small. If this loss is less than the menu cost of changing the prices, the sale will not adjust the price.

There are also indirect costs of price change. Frequent changes entail a loss of customer goodwill. To minimize this loss, firms typically revise the price only when it is made 'necessary' by significant change in costs. Price cutting when demand falls, may trigger a price war and oligopolists are fully aware of the disruptive consequences of such warfare. Therefore, a tacit collusion often emerges among big sellers not to change little flutter in demand or costs.

All these factors go a long way towards explaining why prices may be constant.

Theory of Labor Market

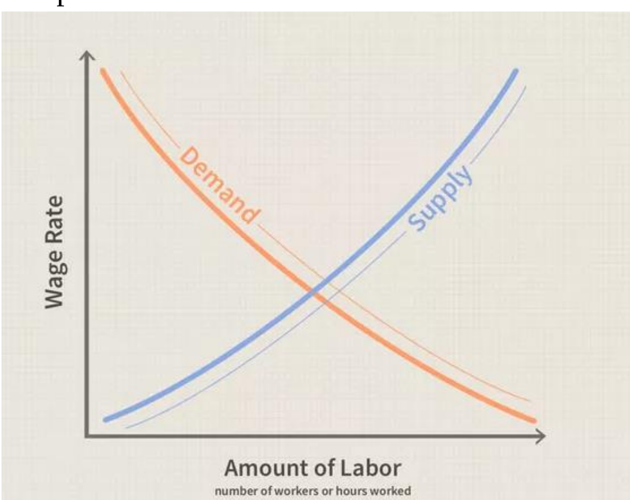
The labor market refers to the supply of and demand for labor. Also known as the job market, it's based on employees providing the supply and employers providing the demand. It's a major component of any economy and it's intricately linked to markets for capital, goods, and services.

It's important and useful to study both the macroeconomic and the microeconomic views of the labor market. Each view can inform government and business outlooks, policies, and actions regarding employment. The labor market plays a major role in any economy.

1. The Labor Market in Macroeconomic Theory

Wage growth lagging productivity growth indicates that the supply of labor has outpaced demand, according to macroeconomic theory. There's downward pressure on wages when this happens as workers compete for a scarce number of jobs and employers have their pick of the labor force.

There's upward pressure on wages if demand outpaces supply because workers have more bargaining power and are more likely to be able to switch to higher-paying jobs. Employers must compete for scarce labor.



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Some factors can influence labor supply and demand. An increase in immigration to a country can grow the labor supply and potentially depress wages, particularly for unskilled jobs.
An aging population can deplete the supply of labor and potentially drive up wages.

2. The Labor Market in Microeconomic Theory

The microeconomic theory analyzes labor supply and demand at the level of the individual firm and worker.

In deciding how much labour to supply (how many hours to work), Mr Sen weighs the cost of work against its benefit. Suppose the hourly nominal wage rate is w and the general price level is P. Then by working one hour in the market Mr Sen obtains w/P units of goods and services. The consumption of goods gives him utility. But work involves the sacrifice of leisure which is also a source of utility. The optimum hours of work involve a balancing of the utility of the consumption gain and the disutility of work (sacrifice of leisure). Figure 2 explains the choice.

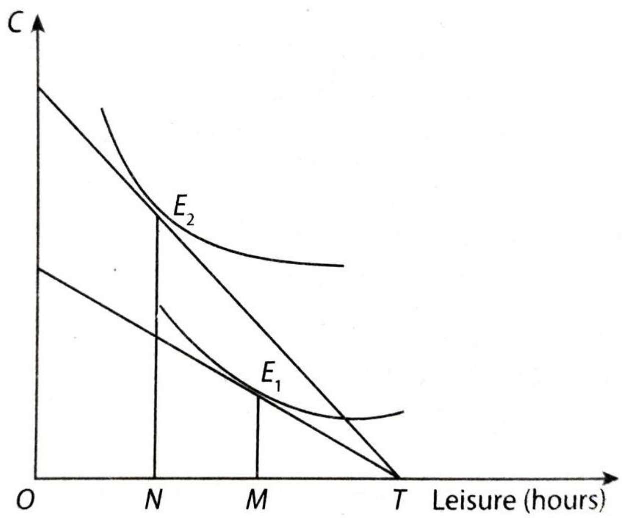


Figure 2: Labour Supply Decision

The vertical axis plots the consumption level of Mr Sen and the horizontal axis plots his consumption of leisure. The total (fixed) number of hours to be allocated between work and leisure is OT. The slope of the budget line is the real wage w/P because by giving up one hour of leisure (moving one unit to the left from T), he gets w/P of goods to consume. For a given real wage, the initial equilibrium is E_1, where OM hours of leisure are consumed (or, TM hours are devoted to work). If the real wage goes up, the budget line rotates up and in the new equilibrium E_2, hours of work have gone up to TN. In this way, we get a positive relation between the real wage and the labour supply of Mr Sen. The aggregate labour supply of the economy at any particular real wage is obtained by summing the labour supplies of all individual agents for that real wage.

A possible objection to the analysis outlined earlier is that, in reality, individuals are not free to choose their hours of work. Most jobs in the formal sector specify the number of hours that must be worked (say, per week). Once accepted, hours on the job cannot be altered. Nevertheless, the situation is different in the informal sector (unregistered small-scale manufacturing units, for example). Moreover, through the choice of overtime or part-time work or variation in the number of family members who are working, control over the labour supply may be exercised.

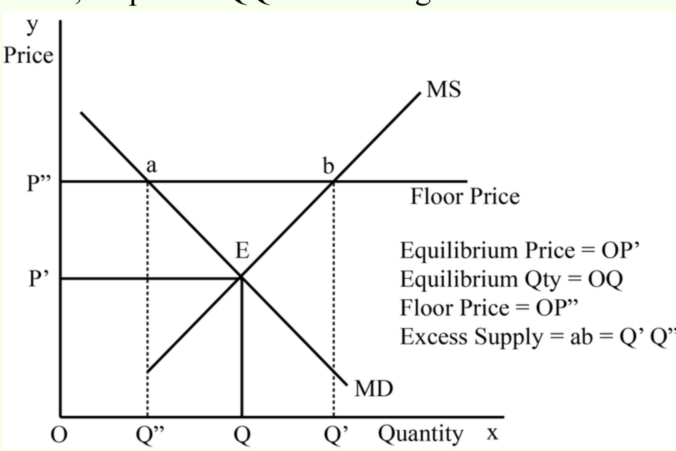
Shift of Labour Supply

Any factor that alters the willingness to work at a given real wage will shift the labour supply curve. Some of the more important factors are:

- If Mr Sen suddenly wins a large prize in a lottery or comes into an inheritance, his lifetime wealth rises and he may choose to work less and enjoy more leisure at the current wage rate. The labour supply curve will shift to the left.
- If the real wage is expected to rise in the future, Mr Sen feels wealthier and may decide to work less now. The curve shifts to the left.
- If the working age population expands, the aggregate labour supply will rise. The curve will shift rightwards.
- If more persons (Mrs Sen, for example) choose to join the labour force due to economic necessity or a change in the attitude to work, the labour supply will rise in the economy.
- If there is a tax on the labour income, a reduction in its rate will bring forth greater labour supply by improving the take-home real wage.

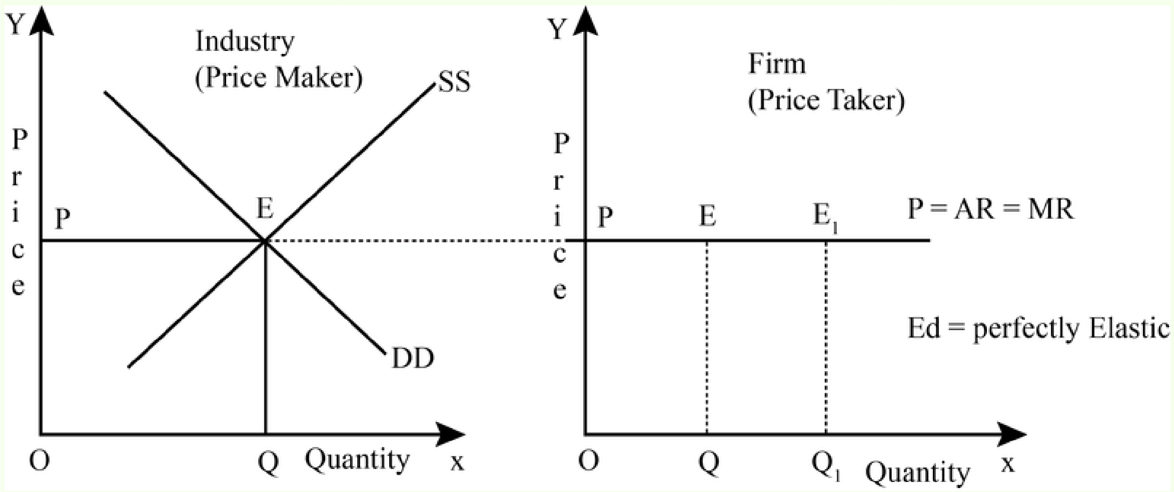
What is a minimum wage rate?

A floor price is the minimum price at which a commodity can be sold legally. It is initiated by the government to support the workers. Floor price if fixed above the equilibrium price, serves the purpose of welfare of the producers (say farmers). When price floor is fixed at P” quantity demanded will contract to OQ” but at this price, suppliers will be ready to supply OQ’. As a result, surplus of QQ” will emerge.



Imposition of floor prices above equilibrium price will have the following major implications:
a) **Surpluses**: The quantity actually brought and supplied will shrink as a direct consequence of price flooring, as a result, a part of producer’s stock will remain unsold. As shown in the figure the surplus of Q’Q” arises.
b) **Buffer Stock**: In order to maintain the support price, the government may design some

programmes to enable producers to dispose of their surplus stocks. One such programme can take the form of buffer stock. Government may purchase the surplus to store or sell it at subsidised prices. Subsidy is required to lower the price and make it competitive in the market. Government may also use it as aid and send it to other countries. (anyone to be explained)
Or
Price of a commodity is determined by market demand and market supply of a commodity, (i.e. industry is the price maker).
An individual producer/firm has no role in the determination of the price of the commodity (firm is a price taker).
No individual seller or buyer can influence the price of the commodity.

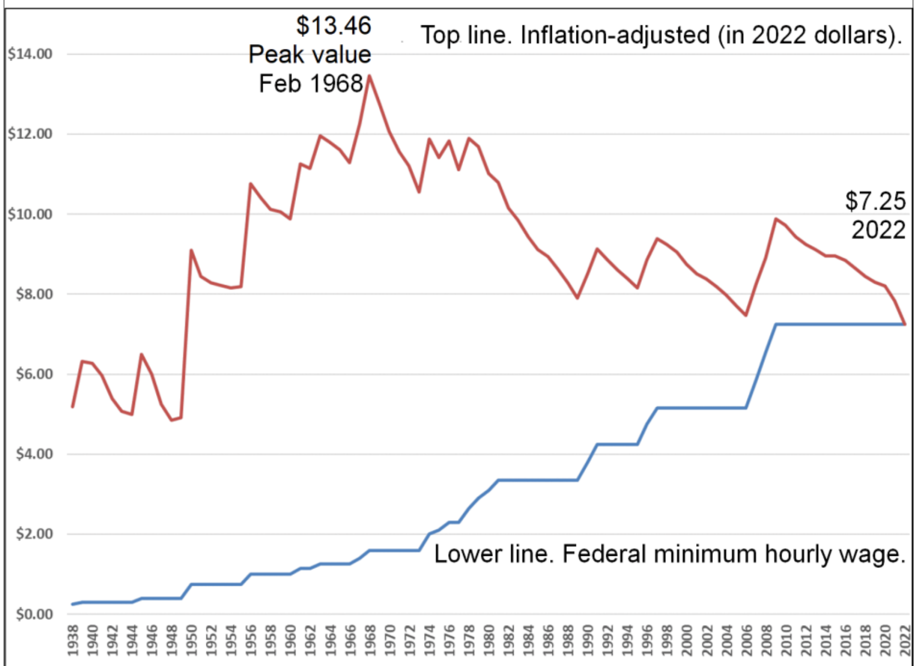


DD and SS are Market demand and market supply curves intersecting at E. OQ quantity (Equilibrium Quantity) would be offered for sale and demanded by the buyers at OP price (Equilibrium Price) per unit. The industry is in equilibrium.

Historical perspective (Literature Review)

The theory underlying the common notion that a rise in the minimum wage is harmful to employment is quite simple: the rationale is that a higher minimum wage will lower frms' demand for workers and thus reduce hiring. This argument is so simple that economists did not question is until the early 1990s. The topic came to the fore at that point because the real minimum wage in the United States had dropped by almost 25% in the 1980s (Elwell, 2014), and this led economists to consider the effects that a minimum wage hike might have on employment, poverty levels and income distribution.

USA. The Federal Minimum Wage 1938 to 2022



Source: Figure created by CRS using data from the DOL Wage and Hour Division, https://www.dol.gov/whd/minwage/chart.htm.

Notes: The inflation-adjusted minimum wage is expressed in 2022 dollars based on the Consumer Price Index for All Urban Consumers (CPI-U), U.S. City Average.

Card and Krueger (1994) were pioneers in conducting systematic analysis of the possible consequences of a minimum wage rise in the United States, by means of quasi-experiments to try to capture the marginal effect of such a rise. They examined the effect attributable to the minimum wage rise in New Jersey —from US$ 4.25 to US$ 5.05 per hour— on employment in fast food restaurants such as Burger King and KFC. Card and Krueger chose the fast food business as a subject for analysis because it usually hires unskilled workers at low wages — precisely those who may be expected to be the most affected by minimum wage hikes. As a control group, Card and Krueger used the fast food business in some cities in the neighbouring state of Pennsylvania, given that the minimum wage there remained constant at US$ 4.25 per hour. The study found no adverse effects on employment and even found some evidence of positive effects. Nevertheless, one of the criticisms of this study was that the trends in employment growth were different in the two states to start with, so that the finding could be an anomaly rather than a universally applicable principle.

Neumark and Wascher (2008) analysed and synthesized the results of over 90 studies subsequent to Card's and Krueger's, on the employment effects attributable to minimum wage changes. These studies include empirical evidence for the United States, some countries of the Organization for Economic Cooperation and Development (OECD), Latin America and Indonesia. The authors concludes that, in general, a rise in the minimum wage reduces employment for less skilled workers. In particular, Neumark and Wascher found wage elasticities of employment ranging from -0.1 to -0.3.

Later, Dube, Lester and Reich (2010) generalized the approach used by Card and Krueger (1994) and made use of differences in wage policy between neighbouring states in the United States to estimate minimum wage effects on income and employment in restaurants and other sectors with a predominant proportion of low-income workers. As well as using a larger number of observations (variations in 1,381 counties), one of the advantages of this study was that the information available covered a longer time period (from 1990 to 2006), which enabled the authors to estimate the longterm effects. Dube, Lester and Reich (2010) concluded that the large negative elasticities obtained in the traditional specifcations were due mainly to differences (regional and local) in employment trends that were not related to minimum wage policies. These authors nevertheless found similar results to those of Card and Krueger with regard to employment (that is, a zero impact) and notably positive effects on income.

Stewart (2004) analysed the impacts of the introduction of a national minimum wage in the United Kingdom in April 1999, and its subsequent increases in 2000 and 2001. Stewart used a difference-in-difference estimator and found no evidence of adverse minimum wage impacts on employment in either case. Another more recent analysis for the United Kingdom also found no evidence of a negative impact (Manning, 2012).

Other studies have focused on developing countries, on the basis that they could be affected differently owing to their higher percentage of unskilled workers. Neumark, Cunningham and Siga (2006), for example, analysed the rise in Brazil's minimum wage, which President Da Silva increased by 20% in 2003 and pledged to double by the end of 2006. These authors found no evidence that the change in the minimum wage had increased income at the lower end of the income distribution, while Lemos (2009) found no effect on employment.

Gindling and Terrell (2009) studied the case of Honduras, analysing the effects of 22 changes in the minimum wage —made between 1990 and 2004— on employment, unemployment and the average wage of workers in different sectors. They found effects only on the income of workers in medium and large firms, where an increase of 1% in the minimum wage led to a rise of 0.29% in the average wage and a relatively large drop (0.46%) in employment. At the same time, the authors found no effects attributable to the minimum wage on the income of workers in small firms or self-employed workers. They did find that a higher minimum wage could create unemployment and transfer employment from large to small firms, which were more likely to disregard the minimum wage rule.

Bell (1997), whose work focused on the 1980s, when the real minimum wage decreased by 45%, found no signifcant minimum wage effects on labour income or formal employment. On the basis of data from the National Urban Employment Survey (ENEU) for the period 1989-2001, Bosch and Manacorda (2010) found that wages up to the median of the wage in the formal sector were affected by the minimum wage and that the erosion of their real value with respect to the wage median (37% between 1989 and 1995) increased inequality at the lower end of the distribution in Mexico. Kaplan and Pérez Arce (2006) analysed the effect of the minimum wage on labour income in Mexico using panel data from the National Urban Employment Survey from 1985 to 2001 and administrative records from the Mexican Social Security Institute (IMSS). They found that changes in the real minimum wage had a positive effect on real labour income, that is, they found evidence supporting the "lighthouse effect" of minimum wages on other income.

However, relatively less is known about the impact of minimum wages on wage inequality in developing countries. The case of developing countries is different due to existence of segmented labor markets. Lemos (2009) using a two-sector model shows that an increase in minimum wage increases the wages in the formal sector and displaces the workers from the formal to the informal sector, leading to a fall in wages in the informal sector. In the developing countries, effects of minimum wage are likely to be ambiguous due to weak enforcement (Bhorat et al., 2021). The compliance to minimum wage changes is also likely to be smaller when multiple minimum wages exist, and little or no penalty clauses are in place (Broecke et al., 2017). The wage and employment impacts of minimum wages hence are shown to vary by institutional factors across developing countries (Neumark & Corella, 2021). An examination of the effects of minimum wage changes on wage inequality, however, remains under studied. For China, Lin & Yun (2016) finds that wage inequality in terms of earnings gap between the median and the bottom decile decreased in cities where an increase in minimum wages occurred in the country during 2004-2009. Engbom & Moser (2021) and Sotomayor (2021) using spatial variation in the bindingness of the federal minimum wage across states in Brazil also find that rise in the minimum wages accounts for a large decline in earnings inequality in the country since the 1990's. Bosch & Manacorda (2010) use variations in minimum wages across municipalities and over time in Mexico to show that the growth in earnings inequality between 1989 and 2001 can be explained in part due to the steep decline in the real value of the minimum wage.

In the Indian context, evidence on the effects of minimum wages on labor market outcomes is limited. It is likely the result of the complexity of the minimum wage system in the country and the fact that it has limited coverage and enforcement (Belsar & Rani, 2011). Distinct from other country contexts like Brazil and Mexico, there is no national minimum floor for wages in India. Thus, the nature, structure and implementation of minimum wages in India is quite different from other contexts. Using variation in state mandated minimum wages for the construction sector and the number of labour inspectors as a measure of enforcement, Soundararajan (2019) finds no effect on wages for low enforcement levels and a positive impact for high enforcement levels while the employment effects are largely null. Menon & Rodgers (2017) finds that from

1983 to 2008, changes across state-occupation level minimum wages in India did not impact the employment but increased earnings and consumption in rural areas. Kijima (2006) and Chamarbagwala (2006) find a rise in wage inequality in India from the 1980's to 2004, while Azam (2012) and Sarkar (2019) examine the changes till 2011 and find that during 2004-11 there was a reversal in these trends. Most recently, Khurana & Mahajan (2020) find that while there was a rise in wage inequality in India during 1983-2004, the wage inequality showed a distinct decline during 2004-2011 which continued during the period of 2011-2018. This decline is attributable to the increase in wages at the lower percentiles. This pattern holds for overall earnings as well as for both rural and urban areas. However, there is no causal evidence regarding the role of minimum wage changes in explaining these trends.

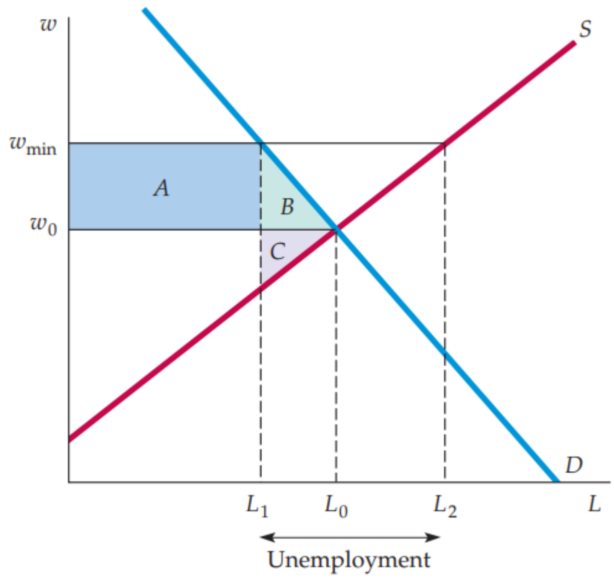
Impact on Employment

Higher minimum wage advocates contend that a higher minimum wage keeps workers and their families out of poverty and averts the personal and societal problems that poverty is known to cause. The federal minimum hourly rate of $7.25, or $15,080 annually, has remained unchanged since July 2009. As a salary, that's $500 over the federal poverty level of $14,580 per year for a one-person household in all states except Alaska and Hawaii in 2023.

Initiatives to increase the federal rate, like the Raise the Wage Act of 2019, have not been successful. The Congressional Budget Office (CBO) published "The Effects on Employment and Family Income of Increasing the Federal Minimum Wage" in 2019 and predicted what would happen if the minimum wage were raised in annual increments from 2020 to 2025 to $10, $12, or $15.

- A $10 minimum would raise earnings for up to 3.5 million workers and "have virtually no effect on employment." Nor would it have an appreciable impact on the number of people in poverty.
- A $12 minimum would benefit up to 11 million workers while reducing overall employment by an estimated 300,000 jobs. The number of people whose annual incomes fell below the poverty threshold in 2025 would be reduced by 400,000.
- A $15 minimum would benefit up to 27 million workers but cost an estimated 1.3 million jobs. At the same time, a similar number of people, 1.3 million, would see their annual incomes rise above the poverty threshold.

The effect of minimum wage policy is illustrated in the below figure, which shows the supply and demand for labor. The wage is set at Wmin, a level higher than the market-clearing wage Wo. As a result, those workers who can find jobs obtain a higher wage. However, some people who want to work will be unable to. The policy results in unemployment, which in the figure is L2 − L1.



In the simple supply and demand model, initial employment is determined by supply and demand, once the minimum wage is introduced, employment falls. The proportion reduction in employment is equal to the proportional wage increase times the elasticity of demand. The monopsony model concludes that the minimum wage reduces employment. If employers do not minimize costs, there is the possibility that they will respond to a minimum wage increase by raising the productivity of their operation to offset the increase (Lloyd Reynolds and Peter Gregory, 1965, p. 193). This possibility is often labeled a "shock" effect- the minimum "shocks" employers into greater productivity.

To measure the employment effect of the minimum wage the ratio of employment to population is used most often as the dependent variable. Unemployment effects are usually measured as the effect of the minimum wage on the proportion of the labor force unemployed.

Negative employment effects are a consistent feature of the studies of low-wage manufacturing and agriculture, but findings are quite mixed elsewhere. In several studies, minimum wage effects are re- ported as the ratio of the percentage change in covered employment to the percentage increase in average wages due to the minimum wage.

Increasing the minimum wage comes with the risk of additional unemployment, depending on the increase in the rate. Some argue that increasing the minimum wage would increase the costs for businesses, resulting in them hiring fewer workers.

Raising the minimum wage has positive impacts, such as bringing people out of poverty and increasing income for individuals and families. However, increasing the minimum wage can also lead to increased unemployment, depending on the wage increase, because employers may seek alternatives, such as technology and automation.

Minimum wages in India

The main purpose of the minimum wage is to protect workers by safeguarding their incomes and providing them and their families with a decent standard of living. This protection is especially necessary for low-skilled workers and those engaged in work without social or legislative protection. The minimum wage helps shield the most vulnerable workers from exploitation (Jones 1997; Melo et al. 2012), and it is often considered an effective way to reduce wage inequality and combat poverty in developing countries (ILO 2016), by providing workers with a minimum level of income (Alaniz, Gindling, and Terrell 2011).

In most developing countries such as India, the minimum wage system is a subject of endless debate. Because of its complex structure, it often faces criticism from all sides: social, political and legal. While multiple issues plague the Indian minimum wage system, the core of the problem lies in the complications associated with the criteria for setting the minimum wage and its associated processes (Varkkey, Korde, and Singh 2016). India has been termed the fastest growing economy in the world, and its development plans have spurred positive sentiments in the global market (Economic Times 2018). Despite this very high rate of growth, multiple challenges remain in protecting workers—particularly in the large informal sector—and in providing them with a minimum wage. This can be attributed to the loopholes in the existing minimum wage policies and legislation and to implementation difficulties.

Yet another crucial problem faced while setting minimum wages is determining their optimal level. Minimum wages can be ineffective if they are set too low, and there is a risk of inflation and unemployment if set too high, the brunt of which is faced by workers in the informal sector, since social protection is practically non-existent (Dawn 2017). Furthermore, there are administrative issues such as delays in the revision of rates and ensuring compliance (ILO 1990; Varkkey 2015). Non-compliance happens more in rural areas than urban ones and affects the informal sector more than the formal sector. In addition, there is a higher probability of women being paid less than men (ILO 2016), even though Article 39(d) of the Constitution of India guarantees equal wages and equal treatment (Varkkey, Korde, and Parikh 2017). Thus, although it may be perceived that the minimum wage is an effective instrument, it has failed to be effective in practice. India was among the first of the Asian countries to enact minimum wage legislation (Minimum Wage Act 1948), soon after its independence. The informal sector in India has benefited from the legislation to some extent, but numerous challenges and hurdles in determining levels, enforcement, implementation and coverage have emerged due to its convoluted structure (Varkkey and Mehta 2012; Srija 2014). The mechanism for setting and implementing the level of the minimum wage in India has been hotly debated since its inception.

India follows a dual system: while minimum wages are set at the national level (central sphere), all states have the autonomy to set their own minimum wages according to their own costs of living and job markets. This often results in confusion about prevailing minimum wage rates and the same type of work represented by different classifications, with a high chance of different wage rates applying simultaneously for the same work. This has resulted in India having one of the most complex minimum wage systems in the world, with more than 1700 prevailing rates. The rates are also set as piece rates, hourly rates and monthly rates and are decided at national, regional and sector levels. However, in truth, there is no such thing as a national minimum wage that can be considered an official benchmark—something that has been persistently demanded by national trade unions.

Furthermore, even though the International Labour Organization (ILO) has established a set of eight guidelines for establishing a minimum wage, India only follows one: inflation and/or cost of living index/economic situation and/or level of development. The law mandates the revision of minimum wage rates every two years, but since they are set by different authorities at different points in time, the entire process of establishing rates and implementing them lacks clear standards, resulting in confusion for both workers and employers (Varkkey and Korde 2013).

Discussions about the long-overdue reform of India's labour market policies have been circulating regarding a better system for determining and implementing the level of the minimum wage, to ensure that the most vulnerable workers are protected and basic social security is made available to them. Reforms are necessary to improve labour conditions and coverage levels. Employers will also have clarity about the minimum wage rates to be paid to workers. There is wide consensus among stakeholders, policymakers, employers, trade unions and academics that the current system is flawed and that there is a pressing need for improvement (Rani and Besler 2012; Carpio and Pabon 2014).

Though the implementation of the minimum wage—with all its limitations— has definitely expanded the scope of decent working conditions, which has especially helped low-paid workers, it has also posed severe challenges, including the difficulty in balancing processes across all three levels of government and guaranteeing suitable compliance, in line with ILO guidelines and in the face of labour market distortions (Carpio and Pabon 2014; Varkkey 2015). Collective bargaining has also not been effective and has not been explored to its fullest in India, though wherever collective bargaining exists, the prevailing minimum wage rate is considered the starting point. Aiming to reform labour laws in general and specifically the wage system, the Government of India has made a proposal by introducing the Code on Wages Bill (2017) and opening the subject to public debate. This bill proposes to empower the central government to set uniform wages for all sectors nationwide (PIB 2017). With the implementation of this law, the issues hampering the ideal implementation of minimum wages are expected to be resolved, and its benefits are expected to cover a large part of the working population. The new bill is also expected to play a crucial part in reducing the obscurities in wage rates and to aid compliance, without affecting workers' income levels and social security. This is one of the first significant initiatives undertaken by the Indian government to merge the existing, different labour laws related to wages (Payment of Wages Act of 1936, the Minimum Wages Act of 1949, the Payment of Bonus Act of 1965, and the Equal Remuneration Act of 1976) into one single code. This move is expected to not only considerably improve the ease of doing business but also ensure a universal minimum wage for all workers. This historical change in legislation, when implemented, is expected to help over 40 million workers (Press Trust of India 2018) across different sectors. Once the proposal is enacted into law, the country will have a statutory national minimum wage rate, and it will ensure that state governments are not able to set their minimum wage levels below the national minimum wage established for that region. This new minimum wage will be valid for all classes of workers. In the current system, the law covers only workers in 'scheduled' industries or establishments (MoLE 2018). In addition to changes in legislation, the government aims to increase financial inclusion through multiple e-governance initiatives such as delivering payments through digital or electronic means, along with extending wage and social security coverage for workers. It also intends to ensure compliance through the use of analytics. To address non-payment and incorrect payment of the minimum wage, as well as the procedural hurdles currently associated with securing legal support, the code also proposes "an appellate authority between claim authority and judicial forum" to ensure faster, cheaper and more effective redress of grievances (MoLE 2018). The dualistic nature of the Indian labour market is evident from its clear segmentation into formal and informal sectors. A substantial proportion of the total workforce is employed in the informal sector (Srija 2014); 90 per cent of the 484 million-strong workforce is employed by the unorganised sector (Srija and Shirke 2012), and it is astonishing to find that the Minimum Wages Act of 1948 is unable to fully cover these workers. The proposed Code on Wages Bill (2017) mandates that this workforce be covered under national labour laws. However, the bill has been severely criticised and characterised as 'anti-worker' by major trade unions, primarily because the wage code compromises the legal rights of the trade unions to access the establishment's accounts (NewsClick 2017; Venkat et al. 2017).

Impact on Business Profitability

Some argue that increasing the minimum wage could lead to higher labor costs and reduced profits for businesses, while others contend that a higher minimum wage can actually benefit businesses by boosting consumer spending and reducing turnover.
Critics of the minimum wage have various arguments that they believe result in particular harm being imposed on businesses, including:

- **Increased labor costs**: Businesses with low profit margins may struggle to absorb the increased labor costs associated with a higher minimum wage, potentially leading to reduced profits or even closure.
- **Fewer job opportunities**: Businesses may be forced to cut back on hiring or reduce hours for existing workers in order to offset the increased labor costs of a higher minimum wage, potentially leading to fewer job opportunities.
- **Unfair competition**: Some businesses may struggle to compete with larger companies that have more resources to absorb the increased labor costs of a higher minimum wage.

Research from UC Berkeley explores whether these fears are actually witnessed in reality, and suggests that they may be overblown. Indeed, the research suggests that businesses don't appear to cut jobs in response to an increase in the minimum wage, and may actually benefit from it instead.

“A minimum wage increase doesn’t kill jobs,” the researchers explain. “It kills job vacancies, not jobs. The higher wage makes it easier to recruit workers and retain them. Turnover rates go down. Other research shows that those workers are likely to be a little more productive, as well.”

A study (Wiltshire et al., 2023) in US has demonstrated that minimum wages set at $15 or higher in various states and municipalities, including California, have improved the financial security of employees, without causing their employers to resort to job cuts.

In the past, business organizations have warned that teenage workers are most susceptible to losing their jobs when the minimum wage is increased. However, the researchers found that higher wages often enabled teenage employees to work fewer hours, leading to increased study time.

These findings carry important implications for public policy, not the least of which is a reduction in poverty and financial insecurity. Additionally, governments currently expend millions of dollars annually on tax incentives for companies that confront government-mandated minimum wage hikes, expenses that may prove unnecessary.

According to the researchers, when employers learn that minimum wages will increase, they typically focus on the impact it will have on their own businesses. They worry about how they can manage the higher costs without having to reduce staff or profits.

However, the authors suggest that if all businesses in the industry face the same shocks and costs, the market response might be a moderate price increase. In fact, some restaurants have already passed on the increased costs to consumers, and the small price increase did not drive them away. Moreover, higher wages result in less employee turnover, less advertising, and less training for new workers, which ultimately benefits the owners and does not harm their profits.

The researchers found that a higher minimum wage led to lower employment only among high school-age workers in small businesses. While employment in that sector decreased, teens overall earned more, enabling them to work less and study more.

Minimum Wage Policy Adopted by Companies

The fifth annual study conducted across 12 e-commerce platforms by Fairwork India, presents a grim picture of working conditions for India's gig workers. Fairwork is a team of researchers, a part of International Institute of Information Technology, Bangalore's Centre for IT and Public Policy.

Only three platforms Bigbasket, Flipkart, and Urban Company had a minimum wage policy to ensure all workers earn at least hourly local minimum wage after factoring in work-related costs, the study said. No platform provided sufficient evidence that workers earn at least the local living wage after work-related costs.

Big basket

1. There was evidence that workers on bigbasket earned at least the local minimum wage after costs. The platform also has a minimum wage policy ensuring the same.
2. bigbasket has policies and mechanisms in place to protect its workers from task-specific risks, including safety training and an SOS button.
3. There are documented policies to provide safety nets, such as insurance, at no additional cost to workers.
4. bigbasket also has policies that provide for loss of pay and that guarantee no loss of standing in case of prolonged absence from the platform.
5. bigbasket's Terms and Conditions are clear, transparent, and accessible in multiple regional languages to workers. The T&Cs are subject to Indian law. bigbasket also has a data protection policy that details the types of data collected from a worker and the measures put in place to protect this data.
6. bigbasket's T&Cs contain provisions that reduce asymmetry in liabilities and provide compensation in case of an outage of the platform's application or systems. The T&Cs do not contain any provisions to prevent workers from seeking redress. bigbasket also has a Code of Conduct in place for subcontractors to ensure all workers are offered the same working conditions.
7. bigbasket has documented channels through which workers can raise grievances, with the option to contact human representatives and appeal disciplinary actions. Workers can approach managers in cases of deactivation of ID. bigbasket also has a policy that ensures workers are not penalised for raising concerns.

Flipkart

1. There was evidence that workers on Flipkart earned at least the local minimum wage after costs. The platform also has a minimum wage policy ensuring the same.

2. Flipkart has policies and mechanisms in place to protect its workers from task-specific risks, including safety training as a part of daily huddles and an SOS button.
3. Flipkart has documented channels through which workers can raise grievances. Workers also have the option to contact human representatives for problems and appeal disciplinary actions. Workers can approach managers in cases of deactivation of ID. And workers are not penalised for raising concerns.

Urban Company

1. There was evidence that workers on Urban Company earned at least the local minimum wage after costs. The platform also has a minimum wage policy ensuring the same.
2. Urban Company has policies and mechanisms in place to protect its workers from task-specific risks, including safety training and an SOS button. Workers are also provided with safety equipment such as harnesses and gloves, at no additional cost.
3. There are documented policies to provide safety nets, such as insurance, at no additional cost to workers. Urban Company also has policies that provide for loss of pay and that guarantee no loss of standing in case of prolonged absence from the platform.
4. Urban Company's Terms and Conditions are clear, transparent, and accessible in multiple regional languages to workers. The T&Cs are subject to Indian law. Urban Company has a data protection policy that details the types of data collected from a worker and the measures put in place to protect this data.
5. Urban Company's T&Cs contain provisions that reduce asymmetry in liabilities and provide compensation in case of an outage of the platform's application or systems. The T&Cs do not contain any provisions to prevent workers from seeking redress.

Issues in minimum wage policy in India

- **Large unemployment**: Ensuring a payment at the minimum wage rate does not ensure employability to a willing worker. Many workers out of desperation then accept a wage below the minimum wage. Workers are too weak and vulnerable to demand their rights and after liberalisation, collective rights to have grown weaker with decreasing power of trade unions. These two factors combined give the employer the capacity to offer employment at wages below the minimum wage rate. There have also been cases where workers are paid wages below the minimum wage floor in government funded road and construction projects.
- **Less protection against inflation**: Real minimum wage rates may decline in the face of accelerating inflation for three main reasons. Firstly, wages are not revised as frequently as prescribed in the norms i.e. not more than five years. In fact it is believed that revision every three years and even alternate years not only to help workers from increasing costs of living but also to improve supervision of the act. Secondly, many states do not provide

for dearness allowance, a safeguard against inflation and finally minimum wages are not linked to a cost of living index.

- **Exemptions from payment of minimum wages**: Government projects have been known to resort to various channels for paying wages below the minimum wage rate. They use methods such as special notifications and exemption clause (26-2) of the Minimum Wages Act. The parliamentary sub-committee, 1987 noted that wages of government programs such as NREP and RLEGP were below the prescribed minimum wage rate. Many professions and industries do not fall under the coverage of the act, for the simple reason that no minimum wage has yet been prescribed, hence employers pay wages on their own discretion.
- **Lack of awareness**: Many citizens are not aware of the existence of a statutory provision that ensures a minimum wage rate. "80% of workers earn less than INR 20/day or less than half of government stipulated minimum wage rate (rural INR 49 and urban INR 67)". On certain instances of doubt among workers on existence of a minimum wage rate, officials have denied claims of any statutory act or legislation.
- **Delays and inaction**: There are delays in appointment of committees for fixation, revision and implementation. A lot of industries and industries do not fall under the purview of the act as their specific minimum wage rates are yet to be fixed. Permanent Labour Inspectors have not been posted in many districts and those posted are known to not visit their districts regularly. For instance in 2008, inspections in Arunachal Pradesh were as low as 7 while Maharashtra reported to have 71651 inspections.
- **Terminology**: The government and its committees have defined three types of wages: 'living wage', 'minimum wage' and 'fair wage'. These concepts are vague in definition and correspond to a utopia where the government and industry could afford them.

Recommendations for Policymakers

Information and awareness-raising campaigns: For example, in the United Republic of Tanzania it was found that workers who knew their rights and legal entitlements were also more likely to be paid accordingly. In Costa Rica, a National Minimum Wage Campaign was undertaken in 2010, which combined awareness raising and information on complaint procedures. A central feature of the campaign was a new telephone hotline allowing workers to report wage violations in a simple and anonymous manner. Awareness-raising activities and information dissemination strategies undertaken by governments and social partners can rely on a range of different channels including the Internet, television and radio broadcasts.

Capacity-building activities for employers' and workers' representatives: A participative process of minimum wage fixing – which allows the minimum wage to be set at a level agreed by workers' and employers' representatives – tends to give the minimum rate more legitimacy with social partners, thereby also facilitating compliance. Besides involvement in designing rates, workers’ and employers’ organizations can disseminate information on minimum wages to their members and provide related advice and support. Training activities for employers’ and workers’ representatives can help to ensure that noncompliance is not due to lack of awareness or misunderstanding.

Empowering workers to claim their rights through individual complaints as well as collective action: In the Philippines, legislation provides that union representatives or workers representing workers’ interests should always accompany labour inspectors during inspections. In other countries, workers’ organizations can bring claims for unpaid wages to court on behalf of the worker concerned.

Measures to formalize the informal economy: Countries should progressively extend minimum wage protections, in law and in practice, to workers in the informal economy through the process of formalization. Disseminating information can potentially improve compliance even in the informal economy, where a widely known wage standard can play a guiding role for wage fixing and alter workers’ and employers’ expectations and behaviour – the so-called “lighthouse” effect.

Targeted labour inspections: The enforcement of minimum wages usually falls within the scope and responsibilities of labour inspectorates. In the context of wages, there is a tendency for inspections to be triggered by complaints rather than proactive identification of inspection targets in the context of labour inspection programmes and strategies. To avoid an entirely reactive complaints-based strategy, proactive strategies could be based on an analysis of the levels and patterns of compliance from labour statistics.

Sanctions that function as a deterrent to non-compliance: Compliance is encouraged when employers perceive a likely probability of being inspected and exposed to penalties. In order to be dissuasive, a sanction regime needs to include penalties that are sufficiently high to act as a deterrent. The length of the proceedings required to impose sanctions also influences the extent to which penalties act as a deterrent. Immediate sanctions are a greater deterrent than longer proceedings, particularly if their outcome is uncertain. In some countries, labour administration agencies are empowered to fine employers for minimum wage violations through fast-track administrative proceedings.

Recovery of wages due and protection against victimization: Enabling workers to exercise their rights to back wages and wages due to underpayment is part and parcel of minimum wage enforcement. In a large number of countries, workers can exercise this right in the courts or through administrative authorities. However, requiring workers to take legal action to recover unpaid amounts is often burdensome and can involve lengthy and costly proceedings. This is why a number of countries provide for simpler administrative procedures. Some countries have empowered labour inspectors to directly order the payment of wage arrears. Monitoring and responsible purchasing practices within global supply chains: While wages and working conditions for the numerous workers engaged in global supply chains are sometimes better than those in enterprises which supply the domestic market (particularly in the informal economy), the existence of low wages and long hours remain a source of concern. Falling prices paid to suppliers have contributed to stagnating or in some instances declining wages, and have made it difficult for suppliers to pay higher wages and sometimes even to comply with minimum wages. Compliance with minimum wages is thus also facilitated by responsible purchasing practices.

Public employment programmes: A positive effect of public employment programmes which pay statutory minimum wages is to promote compliance also in the private sector. This happens because private employers who pay less than the minimum wage risk losing their employees, who will prefer to work in public works programmes or employment guarantee schemes. This improves workers' wage negotiation capacity. In addition, public employment programmes can create awareness among workers about their basic entitlements. By acting as the "employer of last resort", the government can thus encourage compliance in the private sector. Finally, the extent of noncompliance can also vary depending on the design of minimum wage policies and the number of rates, and ultimately depends on the effectiveness of the entire process of designing and implementing minimum wage policies and fixing the adequate level and rate structure in the first place, in full consultation with employers' and workers' organizations.

Recommendations for Businesses

Minimum wage increases can pose significant challenges for businesses, particularly those operating in labor-intensive industries. However, several strategies can help mitigate the impact. One approach is to focus on increasing operational efficiency. By streamlining processes, adopting automation where feasible, and reducing waste, businesses can offset higher labor costs without compromising productivity. Another strategy is to enhance employee productivity through training and development programs, which can lead to higher output per worker and justify higher wages. Additionally, businesses can explore adjusting their pricing strategy by gradually increasing prices to pass some of the costs onto consumers, though this should be done carefully to avoid losing competitiveness.

Maintaining profitability while complying with wage laws requires a balanced approach. One best practice is to conduct a thorough financial analysis to identify areas where costs can be cut without affecting core operations. This might include renegotiating supplier contracts or reducing non-essential expenses. Another practice is to focus on improving employee retention and reducing turnover, as the costs associated with recruiting and training new employees can be significant. Offering non-monetary benefits, such as flexible work schedules, professional development opportunities, or a positive workplace culture, can also help in retaining employees while managing wage costs. Additionally, businesses should continuously monitor their financial performance and adjust their strategies as needed to ensure that they remain compliant with wage laws while sustaining profitability.

Case Study

TEENAGE LABOR MARKETS AND THE MINIMUM WAGE

Increases in the national minimum wage rate (which was $4.50 in early 1996 and $7.20 in 2011) were controversial, raising the question of whether the cost of any unemployment that might be generated would be outweighed by the benefit of higher incomes to those whose wages have been increased. A study of the effects of the minimum wage on employment in fast-food restaurants in New Jersey added to that controversy. Some states have minimum wages above the Federal level.

In April 1992 the New Jersey minimum wage was increased from $4.25 to $5.05 per hour. Using a survey of 410 fast-food restaurants, David Card and Alan Krueger found that **employment had actually increased by 13 percent after the minimum wage went up**.

What is the explanation for this surprising result?
One possibility is that restaurants responded to the higher minimum wage by reducing fringe benefits, which usually take the form of free and reduced-price meals for employees. A related explanation is that employers responded by providing less on-the-job training and by lowering the wages for those with experience who had previously been paid more than the new minimum wage.
An alternative explanation for the increased New Jersey employment holds that the labor market for teenage (and other) unskilled workers is not highly competitive. If the unskilled fast-food labor market were monopsonistic, for example, we would expect a different effect from the increased minimum wage. Suppose that the wage of $4.25 was the wage that fast-food employers with monopsony power in the labor market would offer their workers even if there were no minimum wage. Suppose also that $5.10 would be the wage enjoyed by workers if the labor market were fully competitive.

Does the fast-food study show that employers have monopsony power in this labor market? The evidence suggests no. If firms do have monopsony power but the fast-food market is competitive, then the increase in the minimum wage should have no effect on the price of fast food. Because the market for fast food is so competitive, firms paying the higher minimum wage would be forced to absorb the higher wage cost themselves. The study suggests, however, that prices did increase after the introduction of the higher minimum wage. The Card-Krueger analysis of the minimum wage remains hotly debated. A number of critics argued that the New

Jersey study was atypical. Others questioned the reliability of the data, arguing that a higher minimum wage reduces employment. In response, Card and Krueger repeated their study, using a more comprehensive and accurate data set. They obtained the same results.

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