European Foundation for the Improvement of Living and Working Conditions

Minimum wages in Europe

Background paper

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Introduction

This background paper from the European Foundation ('the Foundation') has been drafted to coincide with the European Parliament's hearing on 12 September 2007 in Brussels on the 'Role of the minimum wage/minimum income for social inclusion in the EU'. The focus of the paper is on minimum wage provisions in Europe; it represents a brief synthesis of relevant Foundation research, supplemented with OECD/Eurostat data where such data is more up to date. It aims to give, in summary fashion, an overview of developments in minimum wage/minimum income provision at Member State level. It also aims to outline the perspectives of the social partners and provide some pointers regarding current and emerging policy issues.

Coverage of minimum wages

An important preliminary observation is that all Member States, as well as many other developed countries, implement some form of minimum wage floor. The following table presents basic data about the level of the minimum wage, the proportion of average gross and net earnings it represents, and the proportion of employees earning the minimum wage for the EU, Japan and the United States (US).

Table 1: *Statutory minimum wages in EU, Japan and US*

Country	Absolute level, 2007 (€/month)[a]	Absolute level, 2007 (€/hour)[b]	As a percentage of average gross wage, 2005[c] or 2006[d] (%)	As a percentage of net average wage (after-tax value), 2006 (%)[e]	Percentage of employees who earn minimum wage, 2005 (%)[f]	Type of rate[g]
EU27[h]						
BG	92	0.58	49	n/a	16.0	monthly/hourly
RO	114	0.71	32	n/a	9.7	monthly
LV	172	1.08	33	n/a	12.0	monthly/hourly
LT	174	1.09	38	n/a	10.3	monthly/hourly
SK	217	1.36	34	40	1.7	monthly/hourly
EE	230	1.44	33	n/a	4.8	monthly/hourly
PL	246	1.54	33	39	2.9	monthly
HU	258	1.61	38	51	8.0	monthly
CZ	288	1.80	39	45	2.0	monthly/hourly
PT	470	2.94	40	44	4.7	monthly

[a] January 2007 data from Eurostat (EL: July 2006 data from Eurostat; Japan: 2006 data from OECD)

[b] January 2007 data from Eurostat (EL: July 2006 data from Eurostat; Japan: 2006 data from OECD)

[c] 2005 data from Eurostat: BG, RO, LV, LT, SK, EE, PL, HU, CZ, PT, SI, MT, ES, NL, UK, IE, LU

[d] 2006 data from OECD: EL, FR, BE, Japan, USA; note that OECD/Eurostat figures may not be strictly comparable given the different base for average wages.

[e] 2006 data from OECD

[f] 2005 data from Eurostat

[g] Eurostat 2007

[h] Seven member states do not have a statutory minimum wage, see p.2

Table 1: *Statutory minimum wages in EU, Japan and US (cont'd)*

Country	Absolute level, 2007 (€/month)	Absolute level, 2007 (€/hour)[b]	As a percentage of average gross wage, 2005 or 2006 (%)	As a percentage of net average wage (after-tax value), 2006 (%)	Percentage of employees who earn minimum wage, 2005 (%)	Type of rate
EU27						
SI	522	3.26	46	n/a	2.8	monthly
MT	585	3.66	50	n/a	1.5	weekly
ES	666	4.15	40	42	0.8	monthly/daily
EL	668	4.18	39	46	n/a	monthly/daily
FR	1,254	7.84	47	55	16.8	hourly
BE	1,259	7.87	40	56	n/a	monthly
NL	1,301	8.13	46	52	2.2	monthly
UK	1,361	8.51	37	42	1.8	hourly
IE	1,403	8.77	52	60	3.3	hourly
LU	1,570	9.81	50	48	11.0	monthly
Japan	774	4.84	28	29	n/a	hourly/daily
US	676	4.23	33	37	1.3	hourly

Notes: 1/ The average wage for the US excludes supervisory and managerial workers. For this reason, ratios shown for the US would be lower if calculated on the same basis as other countries.
2/ Monthly rates apply to full-time employees.
Sources: *Funk and Lesch, 2005; Regnard, 2007; OECD, 2007*

The first important point to note from Table 1 is that a significant majority of Member States implement a wage floor by way of statute. In addition, those seven Member States not included in the above table – Austria, Cyprus, Denmark, Finland, Germany, Italy and Sweden – as well as Norway all have an established tradition of minimum wages set by the social partners through collective bargaining structures, often at sectoral level. The percentage of employees covered by these collectively agreed minimum wages ranges from approximately 70% in Germany and Norway to 90% in Finland and Sweden.

In reality, the distinction between minimum wages that are statutory and those that are collectively agreed is not clear cut. The role of governments is often limited to giving legal force to minimum wage levels established by social partner agreement (for example, in Ireland, Slovakia and Slovenia). In Germany, an even more hybrid situation exists: no federal minimum wage exists, and most minimum wages are collectively agreed; however, sector-specific statutory minimum wages are in place in the construction, roofing, painting and demolition industries. And, of course, in many countries with a statutory minimum wage, this legal minimum wage will tend to establish a base reference for additional collectively agreed sectoral minima.

Whether wage floors exist as a result of government legislation or as one by-product of social partner agreements, the general consensus amongst policymakers at national level on the basic usefulness of wage floors is noteworthy, and especially so given the absence of any specific coordinating EU policy framework.

Minimum wage levels

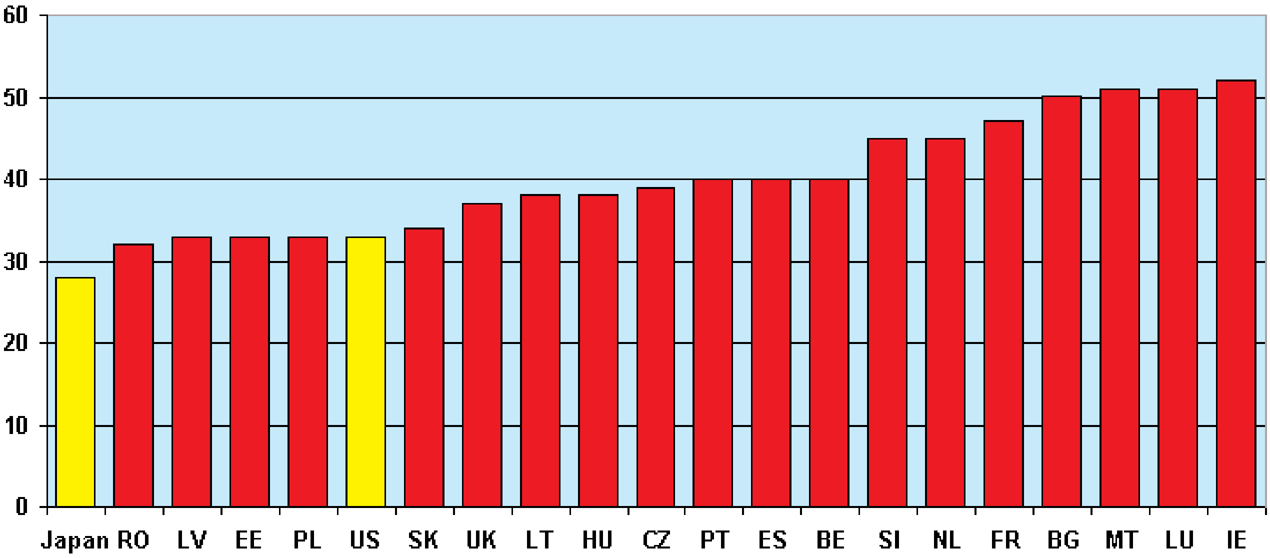
The level at which minimum wages are set vary widely between countries; this reflects in the main earnings variations, which are quite dramatic across the EU. Gross monthly earnings in the highest-earning Member State, Luxembourg, are more than ten times those in the newest Member States, Bulgaria and Romania. Meanwhile, the highest EU minimum wage, €1,570 per month in Luxembourg, is 17 times greater than the lowest – €92 per month in Bulgaria.

Of course, the cost of living is not the same in different Member States and so a euro, or euro equivalent, tends to purchase more in the new Member States, which have lower incomes. Nonetheless, even after conversion to purchasing power parities (PPPs) there is still a big difference in the real purchasing power of the minimum wage across Europe: according to Eurostat, the 17-fold difference between the minimum wages in Bulgaria and Luxembourg is still a seven-fold difference when PPPs are applied.

Given these huge differences in nominal and adjusted minimum wage levels, one common way of making a meaningful country comparison is to compare minimum wages as a proportion of average monthly gross earnings. As indicated in Table 1, the relative value of the minimum wage varies between around 30% and just over half of average monthly gross earnings in those countries with a statutory minimum wage. Countries with the highest proportion (over 45%) include France, Ireland and Luxembourg.

In countries where minimum wages are set by collective agreement between the social partners, sectoral wage floors average at around 50% of the gross average wage in all industries and services; this is comparable to those countries with the higher levels of statutory minimum wages. In some sectors, such as the construction sector in Germany, the figure can be significantly higher, rising to around 70% and more of average gross earnings.

Figure 1: *Minimum wage as percentage of average gross earnings, 2005/2006 (%)*



Source: *Eurostat/OECD*

Intra-EU variations in implementation

Minimum wage provisions tend to vary not just in terms of the levels at which they are set, or the proportion of average earnings that they represent, but also in terms of defining:

- exempted sectors or categories of workers;
- variations in minimum-wage level for specific groups of workers;
- whether minimum wage rates are set hourly, weekly or monthly;
- the methods for updating or adjusting the minimum wage;
- the agencies that play a role in determining minimum wage rates (state, social partners or independent commission);
- the sanctions for non-compliance.

In many countries, separate lower minimum wages are in place for younger workers or for workers in their first years of employment. The main rationale for this is that younger workers, due to their lack of experience and skills – and their lower earning power – would be at particular risk of being priced out of the labour market if subject to the standard higher minimum wage rates. Given general concerns with high levels of youth unemployment, it is not surprising that around half the countries with a statutory minimum wage stipulate lower minimum wage rates for younger workers: this includes Belgium, the Czech Republic, Ireland, Latvia, Malta, the Netherlands, Poland, Slovakia and the UK. In Belgium, to give one example of how youth subminima are implemented, the minimum wage for workers aged between 16 and 20 years starts at 70% of the common minimum wage, at the age of 16. Each year of age thereafter, it increments by 6% per year. Only at the age of 21 are Belgian workers entitled to the full adult-rate minimum wage.

In some countries, such as Spain, reduced rates apply to apprentices; alternatively, exemptions may apply, as in Belgium and France. Different minimum wage rates may apply to people with disabilities, as in the Czech Republic, France, Slovakia and Spain. Other bases for varying minimum wage levels include high-risk jobs, which are paid a higher rate in Estonia, and marital status, as in Greece; exemptions exist for public-service employees in certain countries, such as Belgium and France.

Minimum wage recipients

One broad indicator of the practical impact of the minimum wage is the percentage of workers in a country that earn the minimum wage. In none of the countries covered are more than 20% of the workforce earning only the minimum wage; however, a comparatively high percentage of the workforce, more than 10%, are beneficiaries in Bulgaria, France, Latvia, Lithuania and Luxembourg. This means that the minimum wage serves as a real, practical wage floor cushioning earnings for more than one worker in ten in these countries.

In other countries, including some such as Ireland and the UK, where the nominal minimum wage rates are high and where in recent years they have risen faster than have average earnings, only quite small proportions of the workforce (between 1% and 4%) earn the minimum wage. One explanation is that low levels of unemployment and tighter labour markets can in some countries play a more important role than minimum wage systems in maintaining or increasing wage levels in low-paid jobs.

Global comparisons – EU, US and Japan

When statutory minimum wages are compared from an international perspective, both the US and Japan are at the low end of the EU scale: in most EU Member States, minimum wage earners are comparatively better off than in these other two major developed industrial states.

The recently agreed rise in July 2007 of the US federal minimum wage to $5.85 per hour (€4.30 per hour) from $5.15 per hour was the first such rise in 10 years. Given rises in salary levels, it will have only a minor impact on the US figures in Table 1: the rise has increased the value of minimum wage from 33% to 34% of average gross earnings. Further planned raises in 2008 to $6.55 per hour, and in 2009 to $7.25 per hour, may raise this percentage further; however, the long-term trend has been one of decline in the real value of the US federal minimum wage since the late 1960s. Having said that, 30 US states with approximately 70% of the American workforce mandate minimum wages higher than the federal minimum up to $7.93 per hour in Washington DC.

In Japan, minimum wages are set on a regional basis by minimum wage councils composed of representatives of labour, management and the public interest. A first tier of minimum wages establishes the base minima for each prefecture or regional unit. In March 2006, the weighted average was JPY 668 yen (around €4.80), with higher levels applying in major urban areas, such as Tokyo. In addition, a second tier of higher industry-based minimum wages is in place for specific sectors in given prefectures; in March 2006 these had a weighted average of JPY 761 (around €5.40).

Objectives of the minimum wage

The stated aims of minimum wages may vary from one country to another but they all address, at least in part, the following three challenges:

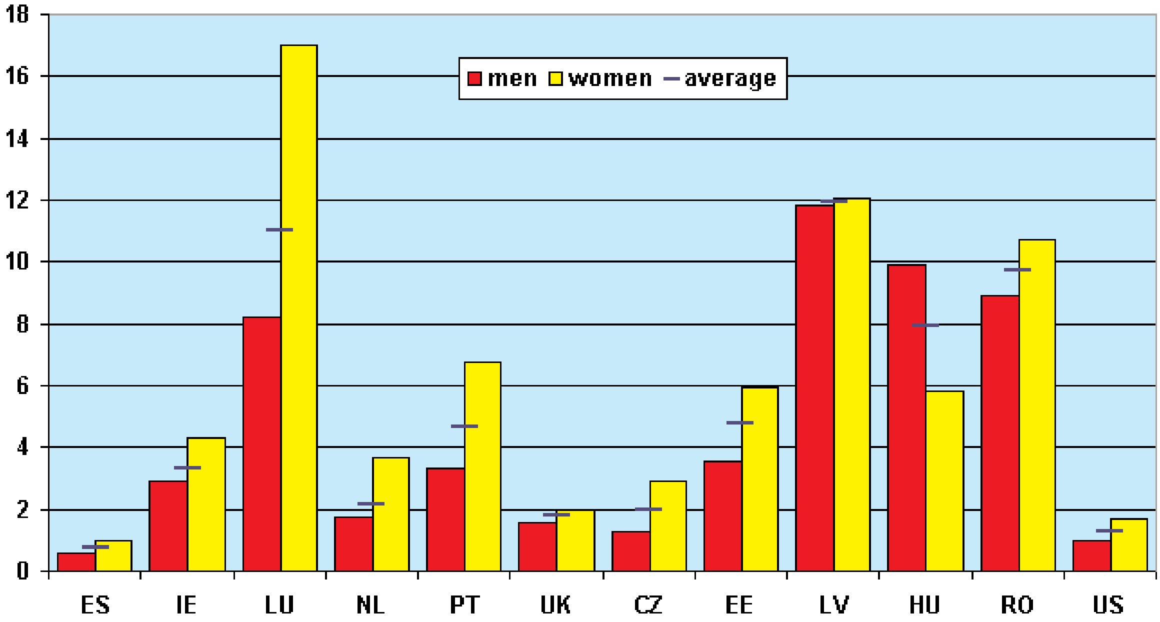
- ensuring that groups at the lower end of the earnings distribution earn a 'decent wage' or a 'living wage'; goals associated with this include reducing poverty and wage inequality; related to these goals are the downward pressures on low-wages caused by technological change and structural changes in the international division of labour (offshoring, globalisation etc.);
- curbing exploitation of vulnerable workers;
- encouraging labour market integration of the unemployed or inactive by 'making work pay'.

An important ancillary goal of minimum wage provision is to improve at least some dimensions of the quality of work. At its simplest, an increase in pay improves conditions at the individual level. Because minimum wages tend to discourage an over-reliance on low-skilled work, they can also improve working conditions at the company and macro level. By raising the price of labour at the lower end of the labour market, minimum wages may spur the rationalisation of low-productivity jobs through investment in labour-replacing technology or through training. Higher-paid work also tends to be associated with other positive work outcomes such as lower levels of turnover and absenteeism (Gregg, 2000). These latter considerations also reflect EU social and employment policy orientations and the strategic objectives set out in the Lisbon programme; a successful future for Europe depends crucially on growth in high-end, knowledge-based economic activity. Minimum wages may have a role to play in reorienting the composition of the labour market to better reach this goal.

Impact on income inequalities

The minimum wage has a role to play in mitigating inequality by cushioning earnings for low-earners in sectors such as agriculture, textiles and clothing, retail and hotel and restaurants.

Figure 2: *Proportion of full-time employees earning minimum wages, by gender (%)*



Note: *Only selected countries are displayed.*
Source: *Eurostat, 2005*

In particular, since there are approximately two women on low pay or on minimum wages for every low-paid man, minimum wages can in principle have a positive impact by reducing the gender pay gap. According to the UK contributor to the 2005 comparative report *Minimum wages in Europe*:

> *The national minimum wage is also seen in positive terms by the government and trade unions not so much as a tool of redistribution but in terms of closing the gender pay gap. The minimum wage is estimated to have had an initial impact in reducing this by a percentage point overall, but with a bigger impact at the bottom of the earnings distribution.* (Arrowsmith, 2005)

According to the final comparative report, 'most countries report that the minimum wage has been important for raising income levels among female workers and facilitating a reduction in the gender pay gap' (Funk and Lesch, 2005).

Arguments against minimum wages

Despite its almost universal application in developed countries, the minimum wage as a policy tool still has its detractors. Neoclassical economics considers minimum wages as inherently distorting and potentially counter-productive (as it does many other well-meaning state interventions in the labour market). By artificially fixing a wage rate below which employers will not be allowed to pay, the minimum wage may in theory threaten the economic viability of certain jobs at the lower end of the earnings distribution. In this way, its critics contend, a minimum wage – especially if set at comparatively high levels - undermines the employment prospects of precisely that portion of the working population that it is intended to help: those in low-skilled, low-paying jobs.

However, predictions regarding the negative employment impact of minimum wages appear not to have been borne out. A review of the empirical analysis of different minimum wage schemes referred to in OECD literature suggests that, while the employment effects of minimum wages are overall very marginally negative, there is some evidence for positive employment effects in certain scenarios (Gregg, 2000). One reason why the negative employment effects are small or non-existent is that rising minimum wages may also encourage higher levels of consumption and therefore of aggregate demand, which in turn creates countervailing positive employment growth.

The UK's Low Pay Commission, in its 2007 annual report, could find 'no evidence demonstrating that the minimum wage has had a significant adverse effect on employment since its introduction' in 1997 (Low Pay Commission, 2007). Independent empirical studies in France have come to similar conclusions. Taking an opposing minority stance, correspondents from three Member States (Estonia, Hungary and Malta) to the Foundation's European Industrial Relations Observatory (EIRO) reported negative employment effects arising from 'strong increases in minimum wages' (Funk and Lesch, 2005). What this tends to confirm is that a carefully adjusted minimum wage rate may not have negative employment effects.

Views of social partners

On principle, employer organisations and trade unions tend to have opposing ideas about the desirability and efficacy of minimum wages; however, signs of both sides reaching some common ground have emerged in recent years.

Trade unions tend to be enthusiastic advocates of minimum wages, which they see as valuable both on the grounds of social justice, as well as for reasons of quality of work. Unions tend to press for higher minimum wage levels, subject to regular revision and allowing as few exemptions as possible. From the unions' perspective, higher minimum wage levels facilitate one of their core functions of wage bargaining, as minimum wages tend to have knock-on effects (especially on other low-wage earners) as different sectors and occupations seek to preserve already established pay differentials.

The attitudes of employer organisations towards the minimum wage differ considerably between countries with statutory minimum wages. Most countries fall into one of two groups. In the first group are those in which employers largely support the existing minimum wage regulations: Hungary, Lithuania, the Netherlands, Poland, and Spain (Funk and Lesch, 2005). In the second group are those countries in which employer organisations oppose the current regulations, regarding them as imposing higher labour costs and so presenting an obstacle to recruitment. This larger group comprises Belgium, Bulgaria, the Czech Republic, Estonia, France, Greece, Ireland, Malta and Slovenia (Funk and Lesch, 2005). In some of the new Member States – for example Latvia – a combination of tight labour markets and rising emigration have made employer organisations more accepting of minimum wage rises, although often they lobby in exchange for reductions in employer contributions. In other countries, such as Estonia, Slovakia and the UK, employer organisations have called for a stronger differentiation of statutory minimum wages with respect to skills, sector and/or region.

The most vocal opposition to increases in the minimum wage comes from bodies representing smaller businesses, and from bodies representing sectors such as retailing, hotels and restaurants: both of these tend to have higher proportions of low-paid workers. A focus of particular criticism is minimum wage increments set above average rates of wage inflation.

Despite the fact that employers and unions have a divergence of interests, minimum wages are a core issue for both groups, notably in those countries without a legal minimum wage and where the setting of wage floors forms part of the regular collective bargaining rounds either at cross-sectoral or sectoral level. Indeed, minimum wage-setting through collective bargaining can be seen as one embodiment of the health of social partnership in Austria, Denmark, Finland, Germany, Italy and Sweden, and tends to reinforce its legitimacy. The main social partner groups in Austria have recently agreed that a minimum wage of €1,000 per month be put in place by January 2009 at the latest. In part, this has been interpreted as an attempt to preserve minimum wage-setting as a social partner prerogative and to forestall the government setting a statutory minimum wage.

Even in those countries with a government-set minimum wage, the social partners have either a direct or a consultative role in periodical minimum wage adjustments.

Limitations of minimum wages

Despite their potential for reducing income inequality, there are some things that minimum wages cannot do. It is important to note that minimum wage arrangements are generally only one component contributing to broader policy objectives including making work pay, improving social inclusion and encouraging labour market activation outcomes.

A number of other complementary measures serve similar objectives. These include:

- specific adjustments to the tax or social security treatment of low wages (including tax credits as is the case in the UK (working family tax credits) and France (*la prime pour l'emploi*));
- supplementary return-to-work benefits;
- other social benefits (health, child allowances etc).

In practice, most Member States have reduced the tax payable on low incomes – both employer and employee taxes –in recent years (OECD, 2006b, pp. 27–31). By increasing the net pay of the low-paid, this policy is clearly consistent with the 'making work pay' objective of the minimum wage.

Given their low levels, minimum wages of themselves cannot protect workers against poverty as it is usually defined (relative poverty being defined as less than 60% of the median equivalised income). As we have seen, the minimum wage level reaches the level of half of average gross earnings in only a small number of countries. A single person working full-time at the minimum wage threshold will still find it difficult in most Member States to escape relative poverty without supplementary social and/or fiscal benefits. (This still applies even when it is taken into account that median earnings are lower than average earnings, and that the net value of the minimum wage tends to be increased by the lower taxes payable on it.)

The inadequacy of the minimum wage for avoiding poverty is especially the case for part-time workers, or workers with family or dependents. For these workers, the minimum wage on its own is insufficient to constitute a living wage: additional support is even more necessary. Minimum wages offer similarly limited protection to workers in casual, irregular or short-term work (such as those on zero-hours contracts). What we can conclude is that minimum wages alone are only a partial remedy for common social policy concerns such as poverty, and need to be combined with other measures in order to make a significant contribution to stated policy objectives.

A Europe-wide minimum wage?

Concepts such as a 'decent wage' or a 'living wage' reflect assumptions that workers should be entitled to an income sufficient to ensure a reasonable and dignified standard of living in return for their labour. A commitment to this effect exists in the Community Charter of Fundamental Social Rights for Workers from 1989 and in similar provisions in the national constitutions of many European countries (e.g. Belgium, the Czech Republic, Italy, Spain and Portugal).

Despite the limited role that minimum wages can play in guaranteeing a decent or living wage, tentative proposals have been made in recent years for a Europe-wide minimum wage policy. A joint proposal by French, German and Swiss researchers envisaged setting an initial common target for EU Member State minimum wage levels of 50% of the average national wage, ultimately reaching 60% (Schulten, 2005). According to this outline, such targets could be reached in the framework of the open method of coordination, with Member State governments agreeing objectives and timetables with regular reporting obligations. This takes account of the fact that Member States have exclusive competence in relation to regulating wages.

Conclusions and discussion points

Nearly 75% of the EU Member States have some form of statutory national minimum wage, with sectoral collective agreements playing the main role in setting minimum pay rates in the remaining 25%. The near universal application of wage floors in developed economies is evidence that the minimum wage as a policy tool has been less controversial amongst policymakers than it has among economists and academics. The negative employment effects of the minimum wage that were predicted in economic models tend either not to have occurred in practice or to have occurred at only insignificant levels. This may be attributable in part to the relatively conservative levels at which minimum wages have been set.

In principle, minimum wages are a subject of contention between the social partners and government. However, in two countries that were late to adopt minimum wages, the UK (1997) and Ireland (1999), initial opposition from employer organisations has mellowed, with reservations being expressed only about the level at which the minimum wage is set. Impact assessments tend to confirm that productivity increases have been such that the introduction of the minimum wage has not brought about ‘any general increase in aggregate unit labour costs’ in typically low-paying sectors (textiles, retail etc.) (quoted in Arrowsmith, 2005).

The minimum wage tends to directly affect a small minority of wage-earners – less than 16% in the EU overall, and less than 5% in the majority of countries with a statutory minimum wage. It is, however, of particular importance in supporting the pay of women, younger workers (despite widespread sub-minima) and those in low-paying sectors such as textiles, retail, hotels and restaurants, security, cleaning and hairdressing.

In a context of growing wage inequality, often assumed to be structural in character, the differential between low earners and medium earners has not widened as much as that between medium and high earners in recent years (OECD 2007, p. 118). In this respect, minimum wages along with other complementary measures (reduced tax on low wages, in-work benefits and maintenance or extension of social benefits for the low paid) may have had some role in cushioning the impact of forces – such as technological diffusion, offshoring, and low-wage competition from third countries – that would otherwise have further depressed low wages in Europe.

The minimum wage alone may have limited direct impact in terms of combating inequality, poverty or ‘making work pay’. It is, however, increasingly seen as an important means of contributing to such policy objectives when taken in conjunction with supporting fiscal, social security and training and activation measures.

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