

**REPORT OF THE INTERDEPARTMENTAL COMMITTEE
CONCERNING THE REVIEW OF
THE CRITERIA TO DETERMINE
THE MINIMUM WAGE**

SUMMARY AND RECOMMENDATIONS

MARCH 12, 2002

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The establishment of the Interdepartmental Committee for the Review of the Minimum Wage follows up on the decision made by the cabinet on October 11, 2000. Its mandate was to determine a frame of reference to guide the decisions to be made concerning the progression of the minimum wage and to suggest a process that would facilitate decision-making. Representatives of four departments participated in the Committee's work. This included the Department of Finance, the Department of Industry and Commerce, the Department of Employment and Solidarity and the Department of Labour.

The first two chapters of this report present two documentary reviews that were made in order to orient Committee discussions. The first review concerns the economic theory of the minimum wage while the second one explains the methods of reviewing the minimum wage that is in force in various countries. The third chapter defines the frame of reference that the Committee adopted and identifies social economic indicators that were used to evaluate the suitability of reviewing the minimum wage and its impacts on the economy. Finally, the last chapter suggests a decision-making process to review the minimum wage in Québec.

Economic theory of the minimum wage

Economic debate concerning the minimum wage has essentially been focussed around two subjects of discussion. These are the impacts that such a policy has on employment levels and its effects on the distribution of wealth. Economic theory generally approaches the impacts that the minimum wage may have on employment using mainly two models. These are a "pure and perfect" competition model (or neoclassical) and an imperfect model called "monopsony".

Over the last 40 years, economic studies based on the neoclassical model show that mainly young people less than 24 years old are generally the most affected by job reductions that are likely to take place when the minimum wage increases. Elasticity calculated by these models varies between -0.1 and -0.3 , meaning that a 10% increase in the actual minimum wage will generate a reduction of employment for young people varying between 1% and 3%. An econometric made by the Department of Finance leads to a similar conclusion for young people aged between 15 and 19.

However, numerous conditions must be met for this model to apply, and because of that, many economists have challenged its relevancy, especially since the nineties. These economists prefer the use of a monopsony model that includes market imperfections. Results obtained using this model are very different from those obtained with the neoclassical model. In fact, they lead to the conclusion that the increases in the minimum wage that occurred over the last 15 years in certain areas of North America and Europe did not hinder employment.

Even though the results obtained using these two models seems contradictory, they may be reconciled. Several economists, including Mr. Pierre Fortin of the *Université du Québec à Montréal*, are of the opinion that the impact of an increase of the minimum wage on employment

depends on the amount of the minimum wage in relation to the average hourly wage. For Québec, Mr. Fortin (1997) defines that relationship in the following manner:

“The actual state of knowledge of the impact that the minimum wage has on employment in North America, and especially in Québec, leads to the conclusion that a minimum wage that is greater than 50% of the average wage is harmful to small wage earners and that a minimum wage that is less than 45% has very little risk for this group of workers. Between these limits, the area of 45% to 50% would represent an increasing danger to employment”.

Within the work done by the Committee, the representatives of the Department of Finance checked the limits provided in the Fortin document. They obtained results that only partially confirmed the Fortin limits. It seems that the impact of an increase of the minimum wage is more harmful to employment when the ratio existing between the minimum wage and the average hourly wage is greater than 50%. However, contrary to Fortin’s conclusions, they obtained a negative impact on youth employment even during the years in which the ratio was only at an average of 41.5%. Such a result can be explained by the choice of variables, the model and the period used for the analysis.

Economists have also debated the impact of the minimum wage on the distribution of wealth. However, a certain consensus exists to the effect that the minimum wage may contribute to increasing the income of low wage earners and in such way, encourage a better distribution of wealth. Several studies that were conducted over the last ten years come to the same conclusion. However, most of these studies add that the minimum wage is not an efficient way of fighting against poverty as only a small portion of economically challenged people have a job. The minimum wage has to be used together with other methods of redistribution.

Methods of determining the minimum wage in various regions

The study of the documentation permitted identifying four methods of reviewing the minimum wage that are in force in several countries. One of these methods is an automatic indexation process based on the consumer price index or on the average hourly wage, but often using loopholes or restrictions. France, Belgium and The Netherlands have chosen this method using different conditions for application.

Several countries establish their minimum wage by government decree. This is especially the case with several Canadian provinces including Québec, Ontario, Manitoba and British Columbia. The United Kingdom also functions this way. In such a case, the government has complete autonomy to establish the minimum wage because no vote is required to approve the decision. In some cases, a study of the economic impact is required before making any changes.

A special procedure applies in the United States. Any change to the minimum wage must be approved beforehand by a Senate vote and authorized by the President. As well, the Secretary for Labour has the duty to present a yearly report on the activities that took place in the preceding year as well as making recommendations as to what should be done over the coming years concerning the minimum wage among other things.

Some countries have decided to confer the review of the minimum wage to an independent body. This is the case in Australia and Mexico where no government action is required. Finally, some European countries have no policy concerning the minimum wage. Germany and Sweden encourage collective bargaining between employers and employees in order to establish the minimum wage for each sector of activity.

Defining a frame of reference for review of the minimum wage

The Committee members have agreed on a frame of reference that includes eleven indicators that are grouped according to four axis of assessment. Each axis refers to different categories of goals and limits that have to be considered in reviewing the minimum wage:

Axis I: The impact that the suggested change will have on the employees' purchasing power and on the contribution to the collective increase in wealth;

Axis II: The impact that the suggested change will have on the ability of companies to compete;

Axis III: The impact that the suggested change will have on employment;

Axis IV: The impact that the suggested change will have on the encouragement to work.

Axis I is above all employee oriented. It includes four indicators that are variations in the consumer price index (CPI), variation of the gross domestic product (GDP), the progression of the average hourly wage and the identification of the main groups that benefit from the minimum wage.

Axis II has five indicators. The first one involves identifying industries that have the largest number of employees working at the minimum wage. The second indicator estimates the impact of an increase that the minimum wage will have on labour costs for businesses. The third indicates the minimum wage paid in various regions while the fourth one is the ratio between the minimum wage and the average hourly wage. The fifth indicator measures the variation in productivity in Canada.

Axis III and Axis IV each have only one indicator. In Axis III, employment-salary elasticity is used to estimate the impact of a change that the minimum wage will have on employment. Axis IV concerns maintenance of the incentive to work that is measured by a model of available income that has been developed by the Department of Employment and Social Solidarity.

Choosing a review process for the minimum wage

In order to facilitate decision-making, the members of the Committee favoured a decision-making process that uses one main indicator. This is the ratio between the minimum wage and the average hourly salary. The decision would be backed by a more general economic analysis using all eleven indicators,

Following such an analysis, the Department of Labour could recommend the increase of the minimum wage that would be slightly distinct from the progression of the average hourly salary, to the extent that the ratio between the minimum wage and the average hourly salary would not exceed 0.47. If the considered increase would place the ratio beyond 0.47, a standing interdepartmental committee made up of representatives of the Departments of Finance, Industry and Commerce, of Employment and Social Solidarity and of the Department of Labour would have to be consulted beforehand and would have to give its opinion. Review would be done annually. The committee members agree that the minimum wage would not be nominally reduced.

As well as giving its opinion when the ratio is liable to exceed 0.47, the standing interdepartmental committee would also suggest solutions to bring the ratio back to 0.47. Every three years this committee would analyze the medium and long-term impacts of the variations in the minimum wage, especially its impacts on the competitiveness of businesses and on the employees' purchasing power.

Committee recommendations

After having completed its work, the Interdepartmental Committee on the Review of the Criteria to Determine the Minimum Wage makes three recommendations:

Recommendation I

The work performed on the definition of a framework of reference for the review of the minimum wage led the Committee members to retain eleven indicators grouped into four axis of assessment. The Committee suggests adopting this frame of reference for future review of the minimum wage.

Recommendation II

As far as the decision-making process is concerned, the Committee members suggest reviewing the minimum wage by using mainly the progression of the average hourly wage. The decision would be supported by a more general economic analysis using the eleven indicators retained by the Committee. Review would be done according to the following conditions:

- When the ratio between the minimum wage and the average hourly wage is less than or equal to 0.47:

The Minister of Labour would present a recommendation to the *Conseil des ministres* once a year on any change to the minimum wage. If this change would have the effect of increasing the ratio more than 0.47, a standing interdepartmental committee made up of representatives from the Departments of Finance, Industry and Commerce, Employment and Social Solidarity and of the Department of Labour would have to be consulted beforehand. When the ratio would be equivalent to or less than 0.47, the committee would not have to be consulted.

- When the ratio between the minimum wage and the average hourly wage exceeds 0.47:

This could happen in only two circumstances:

- 1) When the average hourly wage diminishes. In such a case, the ratio could automatically increase more than 0.47 because of the fact that the nominal value of the minimum wage would not be reduced.
- 2) After an interdepartmental committee would have had the chance to make recommendations concerning the relevancy of increasing the minimum wage so that the ratio would be increased over 0.47 and that the *Conseil des ministres* would have accepted this increase.

The standing interdepartmental committee could also suggest if necessary, the most appropriate method to bring the ratio to 0.47 or less.

Recommendation III

The Interdepartmental Committee Concerning the Review of the Criteria to Determine the Minimum Wage suggests establishing a permanent interdepartmental committee that would analyze the impacts of the progression of the minimum wage on the economy. Among other things, it would analyze its effect on the competitiveness of Québec businesses and on the employees' purchasing power. This committee could also be consulted when the ratio between the minimum wage and the average hourly wage would exceed 0.47 or when a projected change to the minimum wage would increase the ratio more than 0.47.