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The Economics behind the Directive on Adequate Minimum Wages in the EU: A Critical Assessment

Per Skedinger

Research Institute of Industrial Economics
P.O. Box 55665
SE-102 15 Stockholm, Sweden
info@ifn.se
www.ifn.se

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Per Skedinger**

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Abstract

The European Commission's Directive on minimum wages aims to ensure an adequate minimum wage for all workers in the Union and thereby counteract poverty among the low paid. This article examines the underlying economic analysis on which the Directive is based. The conclusion is that job losses associated with sharply raised minimum wages are underestimated while the reduction in poverty is exaggerated, which is why the Commission should have considered other and more effective policy measures. Furthermore, wage developments for low-paid workers in the Union do not seem to be as adverse as suggested by the Commission.

Keywords: Minimum wages; European Union; Employment; Poverty

JEL codes: J31; J38; J88; K31; K33

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** Research Institute of Industrial Economics (IFN), Stockholm, Sweden, and Department of Economics and Statistics, Linnaeus University, Växjö, Sweden.

On 28 October 2020, the European Commission presented a proposal for a Directive on the regulation of minimum wages in the EU (European Commission 2020a). The primary purpose of the Directive, which is intended to be legally binding for all Member States, is to ensure an adequate minimum wage for all workers in the Union, thereby combating poverty among the low paid. An agreement was reached between the European Parliament and the EU Member States on the proposed Directive on 7 June 2022 and it was approved by a large majority of the EU Parliament on 14 September the same year (Euractiv 2022).

The Directive could have very far-reaching consequences for labour markets in the Union. According to the EU's own estimates, up to 20-25 million workers may be directly affected by the Directive, as their wages are below the increased minimum wages that may be introduced. Therefore, it is a reasonable requirement that the underlying economic analysis, which is available in a separate document (European Commission 2020b), be very well substantiated.

Many governments in Europe have embraced the idea that minimum wages can alleviate poverty and boost aggregate demand without large employment losses. The United Kingdom introduced a national minimum wage in 1999 and Germany's *Mindestlohngesetz* came into effect in 2015. In Italy, where minimum wages are set in collective agreements only, there is an ongoing discussion whether the country should follow in the footsteps of the UK and Germany and introduce a statutory minimum (ANSA 2022).

The proposed Directive has, however, been criticised by some Member States. Denmark and Sweden do not want to jeopardise their labour market models, where the parties' autonomy over wage formation through collective agreements is a central component. A further eight Member States have opposed the Directive being legally binding, but that is not enough to block the proposal in the Council of Ministers.[1] In some Member States there are also other grounds for resisting the Directive. Some Member States in Eastern Europe, where minimum wages are already regulated by law, do not want to see their cost advantages over the rest of the EU – in the form of relatively low wages – eroded.

[1] In addition to Denmark and Sweden, Austria, Estonia, Hungary Ireland, Malta, the Netherlands and Poland have protested against the Directive. In order for a directive to be blocked, a vote against it is required from at least 13 Member States or at least four countries that together have a population share that exceeds 35 per cent of the EU's total population (Europaportalen 2021).

The Directive does not stipulate that minimum wage levels be coordinated in the EU. Nor should Member States without statutory minimum wages be forced to introduce such.[2] Instead, the Commission emphasises that minimum wages, statutory as well as those regulated in collective agreements, are the policy instruments that Member States should go for.

The purpose of this article is to discuss the underlying economic analysis of the Directive regarding the effects of increased minimum wages on employment and incomes for low-paid workers and the Commission's presumption of adverse wage developments for the low paid in the Union.

1. The analysis in the Directive

The European Commission's Directive on adequate minimum wages can be summarised in the following main points (European Commission 2020a):

Member States with statutory minimum wages (21 countries) are obliged to:

1. Formulate clear criteria for how minimum wages that allow an adequate standard of living are determined and updated, while employment is upheld

2. Ensure that the social partners have increased influence over how the minimum wage is determined

3. Limit exemptions in the form of lower minimum wages for specific groups or regions

All Member States (27 countries) are obliged to:

4. Promote collective agreements

5. Report annually to the European Commission on measures taken and other relevant information on wage formation

The Directive leaves it to the Member States to decide how high the minimum wage should be in relation to other wages, but mentions as possible reference values 50 per cent of the average wage or 60 per cent of the median wage (European Commission 2020a). Such

[2] However, the legality of the Directive and whether the EU has the competence to adopt the proposal has been disputed from a Swedish perspective (Sjödin 2022). There is also a public discussion on what the Directive will imply for the sustainability of the Swedish collective agreement model in the long run (Bender and Kjellberg 2021). These matters lie outside the scope of the present article.

relative measures are often referred to as the minimum wage "bite" or the Kaitz index. The reference values suggested by the Commission, which are achieved by only a few Member States today, are likely to act as strong signals to the national governments and may lead to political pressure to raise the minimum wage to these levels.

The Commission's rationale for regulating the minimum wage at EU level is, inter alia, that minimum wages increase too slowly as these are completely dependent on national initiatives and the Commission wants to "level the playing field" for companies in the Union, with competition on equal terms.

I will proceed in this section to focus on the analysis of effects on employment and poverty – two key variables from a welfare point of view – in the Directive's supporting document (European Commission 2020b).

Effects on employment

While the European Commission acknowledges that negative employment effects of increased minimum wages do exist, these effects are considered to be so small that they are dominated by favourable effects in the form of higher wages for the low paid. In its analyses of the employment effects, the Commission relies on own-wage employment elasticities for those who are directly affected by higher minimum wages, i.e., workers with wages below the new minimum wage, which have been estimated in previous research. These elasticities show how much the employment of the group in question, where young people and employees in low-wage industries are overrepresented, is affected by a change in the group's average wage as a result of a higher minimum wage.[3] The measure thus explicitly takes into account how wages are actually affected by the minimum wage, i.e., to what extent it is binding.

Many international studies indicate a moderately negative employment elasticity, between -0.1 and -0.2, which means that an increase in the average wage induced by the

[3] This employment elasticity can be written as OWE = (% Δ E / % Δ MW) / (% Δ AW / Δ % MW) = % Δ E / % Δ AW, where % Δ are percentage changes, E is employment for those affected by the increased minimum wage, MW is the minimum wage and AW is the average wage for those affected. Calculation of OWE requires estimation of both employment and wage effects of minimum wages – which is not done in all studies in the field – and should be distinguished from the employment elasticity commonly found in the research literature with respect to the minimum wage, % Δ E / % Δ MW, which has a slightly different interpretation. The European Commission's calculations of the *total* employment effects are based on the equation % Δ E = OWE x % Δ AW x SHARE, where SHARE is the proportion of the total number of employees who are affected by the increased minimum wage.

minimum wage by 10 per cent leads to a reduction in employment of between 1 and 2 per cent, but there is a large variation in the estimated elasticities. The European Commission uses the median of 48 estimated own-wage employment elasticities, obtained from a previous survey of various studies (Dube 2019a). This median amounts to -0.16 and is used by the Commission in the micro-simulation model *EUROMOD* to predict how employment in the Member States with a statutory minimum wage will be affected by increases in the minimum wage to different levels – 50, 55 and 60 per cent of the median wage and 40, 45 and 50 per cent of the average wage.[4] According to the simulations, the total employment losses for Member States with statutory minimum wages would average between 0.01 and 0.1 per cent at the lower reference levels and between 0.4 and 0.5 per cent at the higher levels, but there are large variations across countries.

In the simulations, it is assumed that the employment effects are linear, i.e., the elasticity is -0.16 regardless of how much the minimum wage needs to be raised to achieve the reference values. This assumption can be questioned on both theoretical and empirical grounds. Standard theories for the employment effects of the minimum wage – based on perfect competition, monopsony or search and matching models – predict that the risk of a large negative impact increases when the minimum wage is raised well above the market clearing level.[5] The Commission also ignores the evidence pointing to significant job losses for low-skilled workers in the Nordic countries, which, unlike other Member States, have long since achieved the higher minimum wage levels proposed in the Directive. This is difficult to understand, given that an overview of relevant research in the Nordics is available in a special report commissioned by the Commission (Skedinger 2021).[6]

There are few studies explicitly examining how differences in the size of minimum wage increases affect employment, as most increases are rather small. However, a recent and comprehensive study of the large variations at the state level in the United States in recent years shows that large increases in the minimum wage are associated with substantial job losses (Clemens and Strain 2021). For "large" increases, they find elasticities of -1.01 for young people aged 16–25 without completed high school and -0.41 for all young people aged 16–21, while the corresponding figures for "small" increases do not indicate that employment

[4] See Grünberger et al. (2021) for more details.
[5] See, e.g., Cahuc et al. (2014) for a textbook treatment.
[6] See also the overview in Ek and Skedinger (2019).

is significantly affected.[7] This means that the effect per unit is greater for increases with more units. Similar studies are lacking for EU Member States, but there is much to suggest that the Commission – relying on the strong assumption that employment effects are homogeneous in terms of the size of the minimum wage increases – has underestimated employment losses, especially for vulnerable groups and for the higher minimum wage reference values.

The European Commission should have proceeded from more realistic assumptions about the employment effects and also explicitly taken into account the uncertainty in the estimates. Here, the *Congressional Budget Office* (CBO) - an independent expert body that provides the US Congress with economic impact assessments of various bills - can serve as a model. The CBO's analyses of raising the federal minimum wage from $ 7.25 per hour to $ 10, 12 or 15 include confidence intervals for the employment effects (Congressional Budget Office 2019).

The third main item on the list of items in the Directive – limiting the possibility of setting a lower minimum wage for specific groups – can be seen as a more far-reaching interference in Member States' wage formation than the first one. Today, most Member States allow lower minimum wages for groups such as youth, apprentices, the disabled and others with low expected productivity. The risk of negative employment effects is likely to increase with a more uniform minimum wage, and especially if it is combined with a sharp rise in the level, which is not taken into account in the Commission's analyses. The motto *one size fits all* does not apply to minimum wages.

Effects on poverty

One of the main purposes of the European Commission's Directive is to increase incomes for the working poor. The EU's statistical office Eurostat classifies an individual as poor if he or she has a household income after tax and transfers, adjusted according to the size and composition of the household, which is less than 60 per cent of the median of the corresponding income in the whole economy. The effects of increased minimum wages on poverty depend not only on how wages, employment and taxes and means-tested transfers are affected for those directly affected, but also on indirect effects. The latter include increased consumer prices (for goods and services produced by staff on minimum wages), which can

[7] Minimum wage increases totaling more than $ 2.5 per hour during the period 2013–18 are defined as "large", while increases below this amount are classified as "small". The former increases meant that minimum wages increased by 35 per cent on average and up to 60 per cent in some states.

affect different parts of the income distribution differently, spillover effects from minimum wages to higher wages and the impact on the labour supply of other household members.

It is thus not entirely straightforward to determine how poverty, according to the EU definition, is affected by a higher minimum wage. When estimating the effects on poverty among workers in the *EUROMOD* micro-simulation model, the Commission takes into account effects on wages, employment, taxes and transfers, but not on the indirect effects mentioned above. The simulations predict that the number of working poor in the Member States with a statutory minimum wage will on average decrease from 1-2 per cent (lower reference values) up to 12-13 per cent (higher reference values), again with large variations within the Union. As in the employment analyses, the linear employment elasticity is assumed to be -0.16, the magnitude of which I have previously questioned. It is also problematic that no distinction is made between effects on employment and working hours. If many of those who remain employed at a higher minimum wage are forced to reduce their working hours, the poverty-reducing effect will be overestimated.

The European Commission's hopes for effective poverty reduction through minimum wages appear to be exaggerated, and this for more reasons than underestimating the negative effects on employment and working hours and the omission of price effects. A fundamental problem with using minimum wages to combat poverty is that they miss the target too often – most people defined as poor in the EU do not work or are self-employed and many of those actually affected by minimum wage increases, such as young people, do not live in poor households.[8] This conclusion is supported by several empirical studies showing that minimum wages are blunt instruments for reducing poverty (Neumark and Wascher 2012; Atkinson et al. 2017; Churchill and Sabia 2019; Neumark et al. 2020).[9]

What are the alternatives?

At least as interesting as the material content of the Directive and its supporting documents is what is left out. Among the omissions is the question of whether there are more effective alternatives than minimum wages for reducing poverty. It is not enough to be able to show

[8] According to Arpaia et al. (2017), only an average of 18 per cent of those defined as poor in the EU were employed in 2013. Bruttel (2019) states that only 23 per cent of the poor in Germany were gainfully employed in 2014 and only 27 per cent of the lowest paid workers lived in poor households.
[9] However, Dube (2019b) indicates more favourable effects for low-income households than other studies.

that sharply raised minimum wages – at best – have small negative effects on employment at the same time as wages increase for the lowest paid workers.

Cahuc et al. (2014) argue, after reviewing theoretical research in the field, that taxes and transfers are more efficient than minimum wages for redistribution of income under different assumptions about the functioning of the labour market. An important reason for this is that taxes and transfers can be tailored to meet the different needs of households of different sizes and composition, while minimum wages are "blind" to these differences. Dube (2019b) reasons along similar lines when he claims that transfers and tax credits on wages, like the Earned Income Tax Credit in the US, are better targeted than minimum wages for those with the lowest incomes (Dube 2019b).

Tax credits on wages have the advantage of increasing the incentives to work at the same time as the employers' incentives to hire workers are not negatively affected. As with minimum wages, however, people remaining outside the labour force are not reached and lock-in effects can arise if the credit is phased out as earned income increases. Another disadvantage with tax credits on wages from the point of view of income distribution is that employers can appropriate part of the credit in the form of lower wages before tax (even though the employees seem to gain most from the credit), as the labour supply increases. [10] Furthermore, the tax credit has to be financed in some way - via tax increases, reduced government expenditure or increased government debt – which in turn has consequences for the distribution of income.

In my opinion, a fundamental shortcoming of the analysis is that the European Commission has not considered various alternatives to minimum wages as an effective means of improving the situation of low-paid workers in the Union, as it is far from self-evident that minimum wages should be prioritised over other policy measures.

2. The evolution of minimum wages, low wages and poverty in the EU

The European Commission argues that wages for the low paid in the EU have lagged behind other wages and that it is necessary to regulate minimum wages at EU level so that the gap does not increase even further in the future (European Commission 2020a). The Commission

[10] See, e.g., Azmat (2015) and Rothstein (2010).

also points out that poverty has increased. Furthermore, Nicolas Schmit, the EU Commissioner for Jobs and Social Rights, has argued that regulation of minimum wages at the EU level could prevent a race to the bottom for minimum wages in the Union (Küchler 2020).

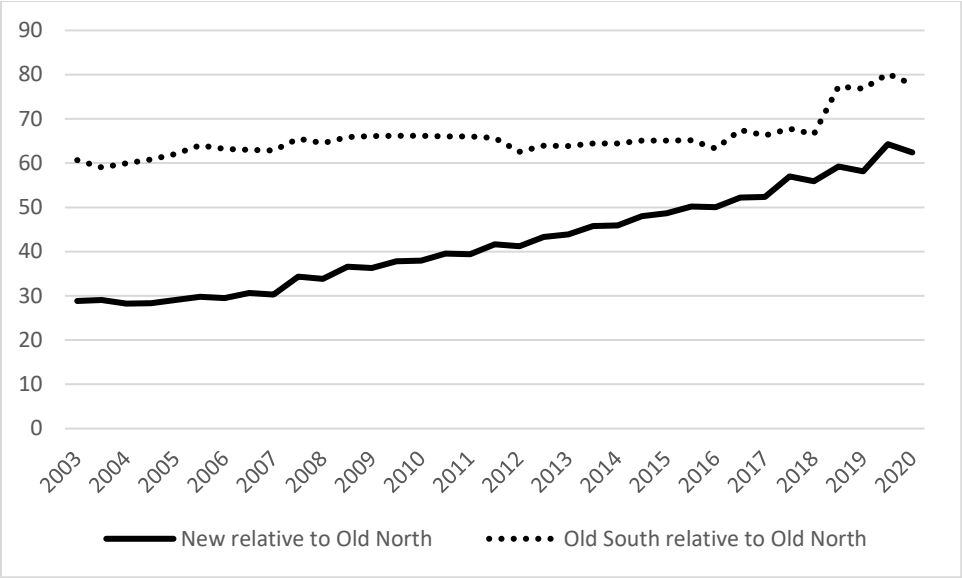
What does the evolution of minimum wages, the wages of the lowest paid workers and the lowest incomes look like in the EU? To answer that question, I use data from Eurostat. I divide the Member States into three groups: the *New*, the *Old South* and the *Old North*. The *New* group includes the countries, mainly located in Eastern and Central Europe, which became members of the Union during or after 2004, i.e., Bulgaria, Croatia, Czechia, Cyprus, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia, Slovenia and Romania. The *Old South* consists of Greece, Italy, Portugal and Spain, while the *Old North* comprises the other Member States.[11] The purpose of this section is to provide an overall picture of how statutory minimum wages (excluding Member States with collectively agreed rates) and wages have grown over time across country groups in the Union with different levels of economic development, focusing on the relationship between the comparatively less developed *New* and *Old South*, on the one hand, and the *Old North*, on the other hand. It should be noted that this level of aggregation, weighted by the size of the countries, hides variations within the country groups that can be significant in some cases.

Minimum wages

Figure 1 shows that average statutory minimum wages in both the *New* and the *Old South* have approached those in the *Old North* over time. This development is particularly pronounced for the new Member States. In 2003, the purchasing power-adjusted minimum wage was on average 29 per cent of its equivalent in the *Old North*, while the share had increased to 62 per cent by 2020. Growth in this relative minimum wage has taken place fairly continuously since the turn of the millennium. For the *Old South*, the relative minimum wage has been significantly higher than for the new Member States, but this too has increased during the period, from 61 to 78 per cent.

[11] The *Old North* thus consists of Austria, Belgium, Denmark, Finland, France, Germany, Ireland, Luxembourg, the Netherlands, Sweden and the United Kingdom. The UK formally left the EU on 31 January 2020 (with a transition period until 31 December the same year), but is included in my presentation which extends until 2020.

Figure 1. Minimum wage in relation to the minimum wage in the *Old North*, per cent



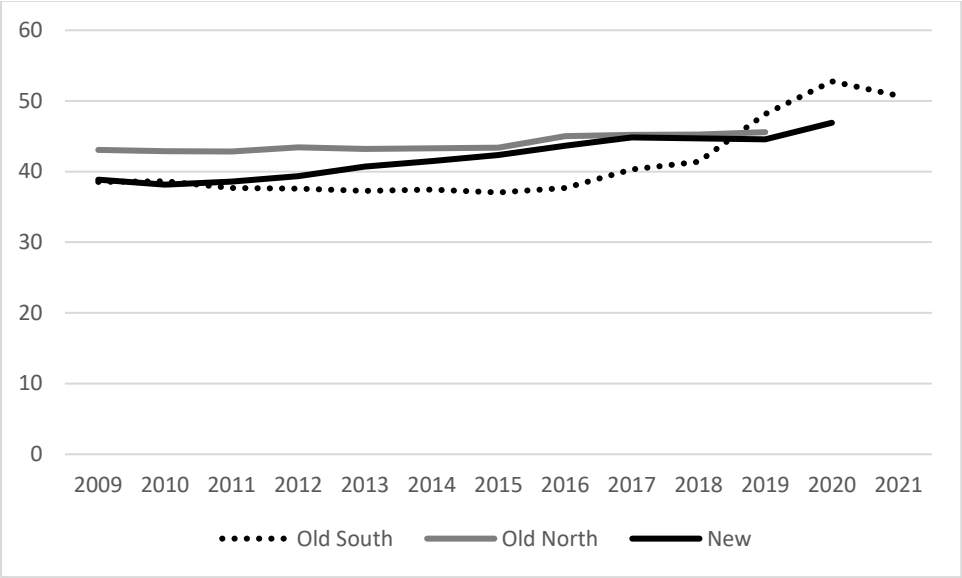
Note: The minimum wage refers to the statutory minimum wage per month, in purchasing power-adjusted common currency (euro), and is weighted by the size of the labour force (15–64 years) in each country. The relative minimum wage is defined as the ratio between the minimum wage in a group of countries and the minimum wage in the *Old North* and is stated as a percentage. See text for definition of country groups. For the group *New*, data for Croatia are missing. In the *New* Cyprus is excluded, in the *Old South* Italy is excluded and in the *Old North* Austria, Denmark, Finland, Germany and Sweden are excluded, as these countries have, or have had, collectively agreed minimum wages (Germany introduced a statutory minimum wage in 2015).

Source: Eurostat and own calculations.

How have minimum wages evolved in relation to other wages in the three country groups? Figure 2 illustrates the minimum wage "bite" or the Kaitz index, for the period 2009–21. The minimum wage as a proportion of the average wage in the *New* and the *Old South* has increased and approached the level in the *Old North* over time. In 2019 – the most recent year with data for all three country groups – the "bite" was 48 per cent for the *Old South* and slightly lower for the *Old North* and the *New*, with 46 and 45 per cent, respectively. The "bites" in the *Old South* and the *New* have continued to increase during the Covid-19 pandemic, although a dip is discernible in the former country group in 2021. Figure 2 thus shows that the minimum wage has increased also with regard to overall wage growth, a development that has not been undone by the recent economic recession. The trend towards smaller differences in minimum wages across country groups and higher levels of these wages has taken place without any coordination at EU level. But it is of course possible that the rapid growth in the *Old South* in recent years has been affected by the European Commission already in July 2019 announcing that it intended to launch the proposal for a minimum wage

Directive that came the following year, in which a minimum wage of at least 50 per cent of the average wage is mentioned as a possible level.[12]

Figure 2. Minimum wage "bite", per cent



Note: The minimum wage "bite" is defined as the ratio between the statutory minimum wage per month and the average gross wage per month for full-time employees in the manufacturing industry and the service sector and is given as a percentage. See text for definition of country groups. For the group *New* there are no data for Croatia and for the *Old South* data for Greece are missing. In the *New* Cyprus is excluded, in the *Old South* Italy is excluded and in the *Old North* Austria, Denmark, Finland, Germany and Sweden are excluded, as these countries have, or have had, collectively agreed minimum wages (Germany introduced a statutory minimum wage in 2015).

Source: Eurostat and own calculations.

Figures 1 and 2 do not provide a complete picture of wage developments for the lowest paid workers in the *New* and the *Old South* in relation to those in the *Old North*. Firstly, Member States where the minimum wages are primarily or exclusively regulated in collective agreements are not included. These countries are six in number, of which one is in the *New* (Cyprus), one in the *Old South* (Italy) and four in the *Old North* (Austria, Denmark, Finland and Sweden). Germany (part of the *Old North*) introduced a statutory minimum wage in 2015 and is not included for this reason. Secondly, minimum wages are not necessarily equivalent to actual wages for the lowest paid workers. Exemptions in the form of lower minimum wages may exist for certain groups in the labour market, such as youth and apprentices, or in

[12] During 2019–20, only five Member States with a statutory minimum wage reached this level: Luxembourg, Poland, Portugal, Slovenia and Spain.

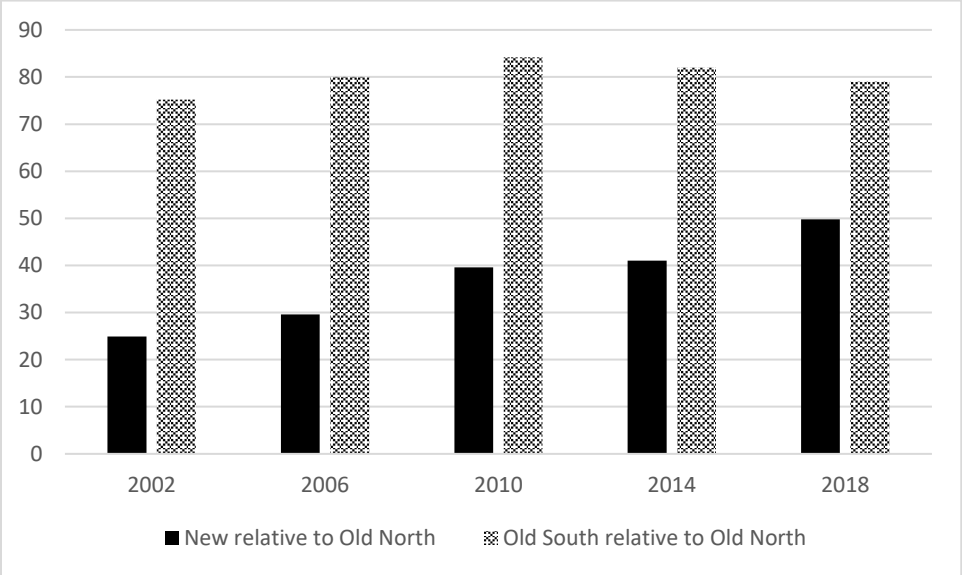
economically weak regions. There may also be non-compliance with minimum wage regulations, implying that workers receive a wage below the prescribed minimum.

Low wages

Figure 3 shows the development of actual, purchasing power-adjusted wages for low-paid workers in the *New* and the *Old South*, defined as the wage in the tenth percentile (P10), in relation to the corresponding development in the *Old North*, between 2002 and 2018. These wages are thus slightly higher than the very lowest wages in the labour market. Information is available only for every four years. There is a clear trend towards convergence between the *New* and the *Old North*. For a person in P10 in the wage distribution, wages in the new Member States increased as a proportion of the corresponding entity in the *Old North* from 25 per cent in 2002 to 50 per cent in 2018. Relative wage developments in the *Old South* have not been as favourable. P10 in relation to the corresponding measure in the *Old North* increased until 2010, and then decreased (to 79 per cent). Thus, growth in relative minimum wages in the new Member States reflects quite well growth in relative actual wages for low-paid workers, while this is not true to the same extent for the *Old South*.[13]

[13] Wage growth can be overestimated if many low-wage jobs have disappeared. This may be the case in the *Old South* in particular, where the financial crisis of 2008–09 led to a sharp rise in unemployment and a weak recovery for a long time thereafter. Minimum wages are not affected by composition effects of this kind.

Figure 3. Wage in percentile 10 (P10) in relation to P10 in the *Old North*, per cent



Note: The wage refers to the gross hourly wage in companies with at least ten employees in manufacturing and construction and the service sector (excluding public administration) in percentile 10 (P10) in the wage distribution, in purchasing power-adjusted common currency (euro) and is weighted by size of the labour force, 15–64 years, in each country. Apprentices are excluded. The relative wage for the low paid is defined as the ratio between P10 in a country group and P10 in the *Old North* and is given as a percentage. See text for definition of country groups. For the group *New*, data for Croatia are missing.

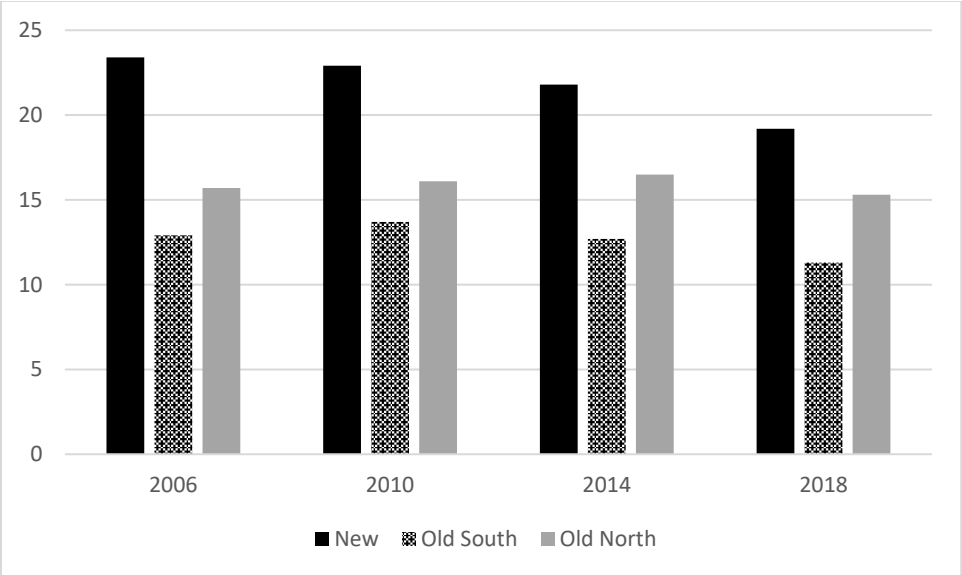
Source: Eurostat and own calculations.

One reason for the more favourable wage developments for low-paid workers in the *New* than in the *Old South* may be that the former group of countries during the period benefited from becoming members of the EU. Dorn and Zweimüller (2021) find that average wages in most of the new Member States approached wages in Germany between 2008 and 2018, even after taking into account differences across countries in the characteristics of workers and their jobs.

Of interest is not only wage developments for low-paid workers, but also their share among employees. Figure 4 shows the share of the low-paid workers according to Eurostat's definition, i.e., with a wage that is less than two thirds of the median wage in each country. As mentioned previously, the minimum wage in most Member States is at a much lower level. The share of low-paid workers is highest in the *New*, but it has decreased from 23 per cent in 2006 to 19 per cent in 2018. Developments are not as unambiguous in the other country groups, but the share of the low paid was lower in both the *Old South* and the *Old North* in 2018 compared to 2006. It is notable that there is no indication that the share of low-paid

workers increased drastically over time in any of the three groups of countries during the period under consideration.[14]

Figure 4. Share of low-paid workers, per cent



Note: Low wage is defined as a wage that is less than two thirds of the median wage. For wage measures, see note to Figure 3. The shares are weighted by the size of the labour force, 15–64 years, in each country. See text for definition of country groups. For the group *New*, data for Croatia are missing.

Source: Eurostat and own calculations.

Poverty

One of the purposes of regulating the minimum wage at the EU level is, as mentioned, to counteract the working poor phenomenon. Figure 5 shows for the period 2010–20 the share of employed in EU Member States who are classified as poor according to Eurostat's definition, which means that the individual has an income, adjusted for the size and composition of the household, which is lower than 60 per cent of the median corresponding income in the Member State. This measure is thus relative and depends not only on the individual's wage, but also on the characteristics of household, hours worked and transfer payments. The upper panel of Figure 5 shows that, for employees, poverty according to this definition is significantly more widespread in the *Old South* than in the other country groups and that it has also increased over time in the *Old South*. In 2018, the share of poor employees in the *Old*

[14] Nor do data from Eurostat indicate significantly increased wage differentials within the country groups, according to standard measures of wage dispersion (P50 / P10, P90 / P10 and P90 / P50). To save space, these data are not reported.

South was 10 per cent, while it was only about half as large in the *New* and the *Old North*. The share of poor workers has decreased in the *New*, while it has been more stable over time in the *Old North*. Surprisingly, poverty rates decreased somewhat during 2020, the first year of the Covid-19 pandemic, in the two country groups for which data are available.

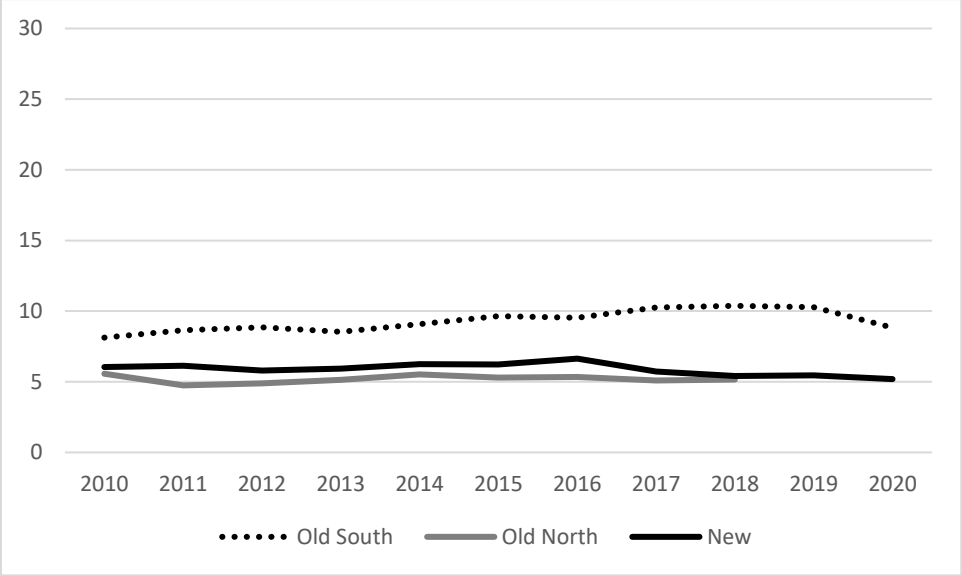
The reduction in the share of low-paid workers in the *Old South* we noted in Figure 4 does not seem to have resulted in a corresponding reduction in the share of poor workers. This indicates that it is not primarily wage formation, but other factors, that have been the main drivers behind the increase in poverty there.

The lower panel of Figure 5 reveals that for non-employee workers, i.e., the self-employed and contributing family workers, poverty rates are considerably higher than for employees in all country groups. Obviously, minimum wages are not very effective in combating poverty for worker groups not directly affected by them. In 2018, the share of poor non-employees stood at 25 per cent in the *New*, 21 per cent in the *Old South* and 19 per cent in the *Old North*, the latter of which has seen a trend increase since 2010. It is also the case that self-employment is more common in countries with more widespread in-work poverty for non-employees, which contributes further to the disparities in poverty between the *Old North* and the other country groups.[15] A considerable share of self-employment among the working poor in especially the *Old South* is likely to be out of necessity – an escape route from unemployment – rather than due to the pursuit of by business opportunity.

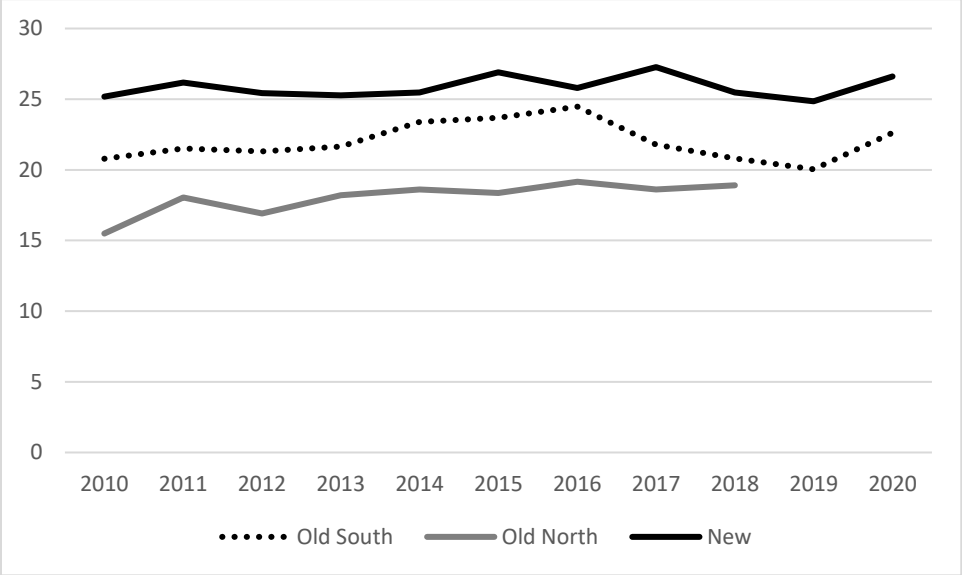
[15] In 2017, self-employment as a share of total employment was, approximately, 20 per cent on average in the *Old South*, 16 per cent in the *New* and 13 per cent in the *Old North* according to Eurostat.

Figure 5. Share of working poor, per cent

a) Employees



b) Non-employees



Note: Poverty is defined as a disposable income, adjusted for the size and composition of the household, which is less than 60 per cent of the median of the corresponding income for persons aged 18–64 who have been working for at least half the reference year. The shares are weighted by the size of the labour force, 20–64 years, in each country. See text for definition of country groups.

Source: Eurostat and own calculations.

3. Conclusions

The European Commission's Directive on adequate minimum wages in the EU could have substantial consequences for tens of millions of workers in the Union. Unfortunately, the underlying economic analysis leaves a great deal to be desired.

My assessment shows that there is much to suggest greater job losses from sharply increased minimum wages than the European Commission acknowledges. It is also disputable whether it is useful to limit the possibilities of having lower minimum wages for groups with expected low productivity, as the Commission advocates. Far-reaching differentiation of minimum wages is a feature of the collectively agreed systems that the European Commission otherwise cite as role models.[16] Furthermore, the Commission's hopes for minimum wages as effective instruments for combating poverty seem exaggerated. The Commission should have considered how minimum wages relate to other policies that can reduce the prevalence of poverty in the Union. One reason why the Commission has committed itself so strongly to the minimum wage track may be that minimum wages can be more readily linked to binding rules than other policy measures, such as the taxation, without causing conflicts with other legislation at the EU level.

The Commission's views on the benefits of minimum wages can be questioned in many respects, and the same can be said for its assessment of the labour market situation for low-paid workers to in the Union. The perhaps most striking finding in this article is how fast the average purchasing power-adjusted minimum wage in the new Member States has approached its equivalent in the old Member States since the turn of the millennium. Nor have minimum wages lagged behind other wages over the past ten years in any of the three country groups considered. Low-paid workers in the country group *New* have also seen their wages increase in relation to low-wage earners in the *Old North* since 2006. The share of low-paid workers has decreased significantly in the *New* and has not increased in any of the other country groups. There are individual Member States with worse developments than is apparent from these aggregates, but this must not obscure the overall picture. There are still large differences in minimum wages and wages across Member States and the process may seem not fast enough, but its direction is clear.

[16] See Ek and Skedinger (2019) and Skedinger (2021) for a discussion on the differentiation of minimum wages in the Nordic collective agreement systems.

The observed wage developments in the *New* are in line with standard economic theory, which predicts that economic integration through, for example, free trade, dissemination of know-how and common technical standards will lead to convergence of average wages across countries at different levels of economic development.[17] Higher capital returns in less developed countries increase the incentives for investing there, with increased productivity and higher wages as a result. Minimum wages can also be assumed to converge, as these are positively correlated with wages. The notion that there is a race to the bottom for minimum wages in the Union, as expressed by the European Commissioner for Jobs and Social Rights, is not supported by the data.

It is mainly low-paid workers in the *Old South* who have lagged behind in relation other Member States and the share of working poor among employees has also increased. The southern European Member States are characterised by a relatively high share of low-educated workers and, in many respects, dysfunctional labour markets, with low mobility, high unemployment and low employment rates. In addition, productivity growth has lagged behind.[18] It is difficult to see that regulating minimum wages at EU level will solve these structural problems. Seen in this perspective, the European Commission's Directive may appear to be a disguised form of protectionism, aimed at the competitive advantages of the new Member States in the form of relatively low wages. It is perhaps telling that no country in the *Old South* opposed a legally binding directive, while several of the new Member States did.

All in all, there are good reasons to be skeptical of the European Commission's Directive on the regulation of minimum wages. A high and uniform minimum wage is not a miracle cure against low wages and poverty.

[17] See, e.g., Dorn and Zweimüller (2021).
[18] See, e.g., Schivardi and Schmitz (2020), who partly blame this on inefficient corporate governance.

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