



**International Conference**  
**on**  
**Minimum Wage and the Welfare State**

**Background Document**

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## INTRODUCTION

In the era of the global economy, issues relating to social policy and the role of minimum wage in the welfare state are always on policymakers' public agenda, but the importance of the debate on these issues is even greater in times of economic slowdown or recession. During periods of economic growth, the debate focuses on such questions as who will enjoy the fruits of this growth, how much, and in the case of unbalanced growth, the opportunities for integrating those who are the weakest links on the labour market and their wages. In contrast, periods of economic slowdown, and even more so crisis situations threaten the welfare state, especially when the authorities tend to opt for a more rigid budgetary policy because of economic upheaval. During such times, there will be a greater debate about the role of the State and the extent to which it should intervene in order to limit the negative effects of dwindling economic activities, primarily on those groups who are most exposed to the impact of the crisis.

The international conference on "Minimum Wage and the Welfare State" is taking place against the background of growing fears that the recession in the USA and the financial crisis currently affecting it will lead to a real slowdown in the world economic growth rate. The effects of the American crisis will be felt in most of the world's economies, including those of Europe and the emerging markets, although it is only natural that those economies which are most exposed to these developments will be most affected by the crisis.

Although in 2008 Israel's economy is stronger and more capable of coping with external turmoil than in the past, it will not be spared the impact of the crisis. Even if the precise effect on the growth rate of Israel's economy is not currently clear, there are fears that low wage levels will be eroded. This is not only because of the fact that, despite years of protracted economic growth, unemployment levels have remained very high among those with low education levels, but also because of the effect on the export profitability of goods in the more traditional industrial sectors, in particular against the background of the revaluation of the shekel. At the same time, pressure is likely to grow not to implement the final phase of the increase in minimum wage, which had been postponed to July 2008, and to adopt an even tighter public spending policy, especially in social welfare services, in order to avoid harming the credibility of external economic policy. Such an approach is likely to increase poverty levels and further aggravate economic disparities in Israeli society, which are already very marked, not only in terms of Israeli history but also relative to the international situation. So far, Israel's recent years of growth have not led to any real improvement in relative poverty levels, nor have they reduced the proportion of the population which counts as the working poor. The growth in employment, which in and of itself was a positive development and involved all sectors of the economy, has not been accompanied by a genuine improvement in the wages of low-paid workers and those working in the traditional industries, and the services and commercial sectors.

**The conference is an opportunity** to discuss economic and social aspects of contemporary developments, as well as to highlight the key goals of a minimum wage and its role in social welfare policy in combination with alternative or supplementary means designed to achieve similar goals. It should be remembered that the developments which led to downward pressure on low wages are still with us today: the opening up and liberalization of the markets, structural changes in production and

the labour market because of technological developments and the decline in demand for unskilled, uneducated workers, worker migration as part of the globalization process and the weakening of the trade unions. These trends have also characterized Israel, and in the Israeli case we must also add the reduction of the system of welfare for working-age families.

**The conference will provide a platform** for exchanges of opinion and mutual learning from the diverse experiences accumulated in a variety of countries, not only on the level of economic-social development that characterizes them, but also in terms of their welfare regimes and their prevailing patterns of cooperation between the social players and the system of labour relations. The conference will naturally also address the dilemmas that have emerged in the areas of minimum wage and its interface with welfare policy, as well as solutions that have been proposed or actually implemented in social-democratic Europe or the USA with its neo-liberal approach.

**The conference is an opportunity** for policymakers and those involved in determining wages in Israel to be exposed to the prevailing positions in Europe and other developed countries with regard to minimum wage policies, and to learn about their impact on employment, poverty and wage disparities on the one hand, and the situation and working conditions of low-waged workers on the other. The importance of the conference and its contribution to the public in Israel is **further heightened** at the moment, not only in light of the dark cloud hovering over the world economy, but also against the background of the start of discussions with the OECD about admitting Israel as a full member of the organization. From this point of view, it is important that policymakers or experts from Europe also be exposed to policy in Israel and differences between the various prevailing outlooks present in the Israeli public.

## **MINIMUM WAGE – GOALS, JUSTIFICATION AND LIMITATIONS**

Many of the world's countries, both developing and industrial, have recognized the necessity of a minimum wage in the framework of the law, regulations or collective agreements. A minimum wage is a recognized policy instrument for intervention in the labour market in order to achieve the following **social goals**

**i. Guaranteeing a fair wage and minimum income enabling the worker to enjoy appropriate conditions of existence relative to the accepted standard of living among the population**

**ii. Reducing poverty among workers and reducing wage and income disparities**

As for the issue of measuring poverty, many countries are considering yardsticks for determining minimum-wage levels. As early as the 1970s, the International Labour Organization tried to suggest that when setting a minimum wage, its member states consider two areas: the first relates to the needs of workers and their families, taking account of wage levels in the economy, the cost of living and the relative standard of living of other social groups. The second area involves economic factors such as labour productivity, employment levels and growth. Such a general formulation offers broad scope for latitude on the part of policymakers, and hence unsurprisingly countries differ widely in the solutions that they have each adopted on the basis of their specific social and economic circumstances.

The economic literature contains a number of **arguments that support** the existence of a minimum wage. There are two key arguments: **the first is the reduction of the market force of employers with regard to low-skilled workers** – the latter typically have low education levels and little experience on the labour market, especially in cases where workers do not have many employment alternatives near where they live and the employer has monopsonist power over them. Like other institutionalized arrangements, minimum wage is a tool that can be used in overall bargaining between workers and employers and **its role is to prevent the use of the cheap-labour whip** and to limit the space for bargaining about wages to what society agrees is a reasonable range. The grounds for the introduction of the minimum wage are principled and not just economic, and its level is also the result of negotiations and not of an economic consideration derived from the concept of the worker's marginal output. **The second argument** is that the minimum wage increases the wages of the low-skilled, helping in this way – as long as it does not bring about a significant increase in the wages of the rest of the workforce – **to improve income distribution without any budgetary cost.**

Minimum wage is likely to have **negative consequences**. **First of all**, on a competitive market minimum wage is likely to have a **negative impact on employment** to the extent that the minimum wage is higher than the worker's marginal output. In particular, demand for low-skilled workers will drop and unemployment among them will increase, while at the same time demand will rise for workers with high-level skills who will also be paid higher wages. As a result, not only will the goals of minimum-wage policy not be achieved, but this very policy might itself prevent their attainment. It is therefore preferable for the minimum wage to be set on a level which will enable the social goals to be achieved. **Secondly**, to the extent that there are **problems with implementing** the minimum wage, and in particular when there is no enforcement in certain sectors, the minimum-wage policy is likely to fail to achieve the goal of reducing income disparities. To this must be added discrimination between sectors and companies in the same sector where there is a flexible supply of low-wage labour. **The need to solve the enforcement problem becomes even more pressing** given labour migrants' great mobility and their poor employment conditions. **Thirdly**, in economies which have index linking of the variety where pay scales are linked to the minimum wage, whereby a starting or minimum wage is linked to some wage parameter in the economy, a process is likely to occur where wages go up unrelated to any increase in work output, and where there is a more marked negative effect on employment.

## **Minimum wage in Israel – milestones and characteristics**

### **Main milestones**

**1972** – Signing of the first collective agreement on minimum wage between the Histadrut (General Federation of Israeli Workers) and the Coordination Bureau of the Economic Organizations. An expansion order applied this to other sectors of the economy also.

**1987** – Enactment of the Minimum Wage Law at the level of 45% of the economy's average salary. The law laid down a mechanism for automatically updating the minimum wage on the basis of wages and prices.

**1997** – The minimum wage was increased to 47.5% of the average wage, to be updated once a year based on the change in the average wage instead of once every

two years according to the average wage, and once every two years according to price increases. Changes were also made to the definition of the wage components taken into account in order to determine the addition to the minimum wage and the number of hours represented by a full-time job.

**2002-2005** – Freezing of the minimum wage in order to reduce the cost of labour as part of policy during the recession period.

**2006-2008** – Gradual increase in the minimum wage above the level derived from the rate laid down in the law, but for a certain period only. Today the minimum wage is NIS 3,710 a month, and it will go up to NIS 3,850 in July 2008 (50.8% of the average wage). After that the minimum wage **will not be updated** as long as its level is higher than the rate laid down in the law. In other words, in the near future, the minimum wage will revert to 47.5% of the average, as defined in the National Insurance Law.

### **CHARACTERISTICS OF THE MINIMUM WAGE IN ISRAEL (2006)**

Table 1, which appears at the end of this document, presents the key characteristics for the population of wage-earners in Israel who earn wages up to the minimum wage. The population's characteristics are as follows:

- In 2006 the minimum wage was **42% of the average wage** for a salaried worker employed full time, and **56% of the median wage** for a salaried worker employed full time.
- **Some 13% of salaried workers** in Israel earn a per-hour wage which does not exceed the minimum wage per hour. This applies to **some 276,000** workers, most of them (around 70%) employed on a full-time basis. **Some 19%** earn up to 1.1 times the minimum wage.
- In the population who earn up to the minimum wage, there is a striking **over-representation of Arabs and new immigrants**, of **young people**, of people with **low education levels**, and of part-time workers.
- **Women are over-represented** among workers earning up to the minimum wage.
- In a comparison of sectors and occupations, there is a striking **over-representation** of workers **in the sales and service sectors** and of **non-professional** workers.
- The minimum wage plus children's allowances **does not guarantee** an income above the poverty line for families with a single breadwinner. Thus, for example, the minimum wage plus children's allowances for a family with 2 children is equivalent to just **80%** of the poverty-line income appropriate for this family.
- **Some 12%** of working families in Israel are poor. In other words, their available income is lower than the poverty line. The population comprising those who work at minimum-wage levels and below does not completely overlap with the population of poor workers. **Around 60% of all poor workers and 40% of those poor workers who are employed on a full-time basis earn a salary equivalent to or less than a minimum wage.**

Like the trends in the population as a whole, the extent of poverty among working families has expanded greatly since 2000. Poverty defined by available income has **gone up from 9% to 12% in 2006**. This development derives mainly from the cutbacks in the system of welfare allowances for the working-age population.

### **THE MINIMUM WAGE – THE INTERNATIONAL ASPECT**

#### **Minimum wage in law and in collective agreements**

**In 20 out of 27 member states of the European Union**, the minimum wage is **grounded in law**. In the remaining countries – Austria, Cyprus, Denmark, Finland, Germany, Italy and Sweden – the minimum wage is set in **collective agreements that**

**cover between 65% and 90%** of all of their economy's salaried workers. In the USA too, the Federal minimum wage is laid down by law, with most of the states of the Union having introduced a minimum wage which is higher than the Federal one.

**Striking developments** in minimum wage arrangements in the last decade took place in Britain and Ireland, which enacted a minimum wage law. In **Britain**, the law came into force in **1997** and was implemented gradually, with a monitoring commission keeping an eye on the implementation of the Minimum Wage Act and its implications for the economy and society. In **Ireland** the legislation was enacted in **1999**.

Given the global trends, which affected Europe also, and the relatively high unemployment levels in the European Union, it was feared that the trade unions would lose even more of their bargaining power and their ability to secure a minimum wage in agreements. Discussion of the arguments for and against minimum-wage legislation occupies an important place in countries which do not have minimum wage legislation. **In Germany, the debate about the need for legislation has intensified since 2004.** Critics of the idea of legislation highlight the danger of growing unemployment in the absence of flexibility on the labour market during a recession and the threat to collective bargaining, while its supporters underscore the social role of such legislation and note Britain's positive experience in the field. Germany is the only country (without a minimum wage law) that does not have sufficient mechanisms to expand the minimum-wage agreements. **The advantage of the Scandinavian countries is to be found in their tools that guarantee high levels of coverage by collective agreements and unionization rates,** which cover over 90% of workers. Members of the **Austrian government are also in favour of minimum wage legislation,** even though the collective agreements have been expanded to cover almost the entire workforce.

#### **Minimum wage as a "living wage" – the example of the USA**

The Living Wage Movement, active in the USA since the mid-1990s, led to legislation on increasing the minimum wage. **In 2006 it was decided to gradually increase the Federal minimum wage,** after it had remained unchanged in nominal terms since 1997, at \$5.15 an hour. The minimum wage went up to \$5.85 in July 2007, and is due to go up to \$6.55 in 2008 and \$7.25 in mid-2009. Even prior to the increase in the minimum wage, it was higher than the Federal level in 29 states of the Union. Furthermore, in 140 local authorities in the US, a "living wage" law was enacted which guaranteed a per hour wage which varied between \$9 and \$11 an hour. Supporters of increasing the minimum wage argue that in the last decade (since 1997 and up to the new legislation), the minimum wage had eroded not only relative to prices by some 40%, but also relative to the real increase in labour productivity (erosion of some 30%). The increase contained in the new legislation reflects a real growth rate of just 4% compared with 1997.

A "living wage" is a concept which is closer in terms of definition to that of poverty. Some define it according to a relative approach (a wage that enables workers to support their families and be sure that they will have the means and leisure to participate in the life of their community), while others define it as a budget comprising a basket of basic products. Those who support a living wage argue that its level should be above the official poverty line in the USA (at least 150% above the poverty line for families with children).

### Minimum wage level

Table 2 shows a number of minimum wage characteristics in Europe, the USA, Japan and Israel. European countries which have a minimum wage law can be divided into three groups by minimum wage levels in absolute terms. The **first group** includes Luxembourg, Belgium, the Netherlands, France and Britain with a **minimum wage per hour** varying between **€8 and €9**. In the **middle group**, which consists mainly of countries from Southern Europe, the per hour minimum wage varies between **€2.5 and €3.8**, while in the **third group**, which includes countries of Central and Eastern Europe, the minimum wage varies between **€0.5 and €1.5** an hour. When expressed in terms of purchasing power, the disparities are considerably reduced, from a ratio of 1:13 to one of around 1:4.5. The per hour minimum wage **in the USA and Japan (€4.2 and €4.8 respectively)** is closer to that of the middle group of European countries.

Calculating **the minimum wage as a percentage of the average wage in the economy** reveals relatively great diversity in relative levels: **in Ireland and Luxembourg the figure is 50%-52% of the average wage respectively, in Japan 28%, and in the USA and most Central and Eastern European countries 33%**. In countries which have a minimum wage that is laid down in collective agreements, the sectorial minimum wage is around 50% of the average wage in the local economy as a whole. In certain sectors in Germany, the minimum wage even reaches 70% of the average wage.

**The minimum wage in Israel, which is tied to purchasing power, ranks low in comparison to the countries of Western Europe, but higher than the level characteristic of Southern European countries. However, Israel is one of the countries where the minimum wage is relatively high compared with the average wage – above 40%.**

### The winds currently blowing in the European Union

Against the background of the integration of Europe's labour markets, a debate is underway of such questions as whether there is justification for intervention on the European level when it comes to setting a minimum wage, and if so in which fashion", and should the European Union only work out the outlines of the desired policy, and leave the specifics to be set by the individual country? Given the fact that the European Union can be viewed as a single economy, it is also logical to view the European labour market as a single market, especially given the movement of workers which is likely to expand in the future. Some (like the French Left) think that Europe should develop a uniform minimum wage policy, while others hold that only guidelines should be laid down. One of the proposals is for coordination, so that a minimum wage would gradually come to be equivalent to 50% of the national average income in each of the Union's member states. The Union's authorities would be responsible for implementation and monitoring. At the same time, it has also been suggested that an independent body be set up along the lines of Britain's low wages commission, which publishes follow-up reports on a regular basis.

### **THE EFFECT OF INCREASING THE MINIMUM WAGE ON EMPLOYMENT AND POVERTY**

In a comprehensive study, Neumark and Wascher (2006) compiled empirical evidence from research which examined the influence of increases in the minimum

wage on employment in a number of countries, with the emphasis on the USA. They note the following conclusions:

- There is no general agreement about the effect of increasing the minimum wage on the employment of the low-paid, and there is a relatively broad range of estimates.
- At the same time, quite a few studies point to minimum wage having a negative effect on employment, even if it is not always clear-cut.
- Only a few studies point to a positive effect, and in general they concentrate on special, restricted industries.

It should be emphasized that a considerable proportion of the studies undertaken in the United States related to adolescents or very young workers. Moreover, in most developed countries, the minimum wage applies to a relatively low percentage of salaried workers – not only because most employees earn more than the minimum wage, but also because in non-negotiable sectors we would not expect to find a negative effect on employment (any increase in the minimum wage will be absorbed by increasing prices).

**The British experience** in the wake of minimum wage legislation shows, according to a 2007 report by the committee following up the implementation of the law, that there is **no evidence** that the minimum wage had any clear-cut negative effect on employment.

The effect of the minimum wage **on poverty or inequality** depends inter alia not only on the effect of the minimum wage on employment, but also on the minimum wage level. The question is whether the minimum wage is on a level sufficient to enable workers and their families to break out of the poverty cycle. The minimum wage relates not to the poor, but to a broader working population. Findings about the impact of the minimum wage on poverty are not uniform, although most point to a positive effect. The “living wage” in the USA has also been found to have an effect in limiting poverty. The effect of the minimum wage on overall inequality in the population is, naturally, fairly limited.

## **INTEGRATING MINIMUM WAGE IN A “MAKE WORK PAY” POLICY**

In recent years, there has been increasing evidence of **minimum wage as an important tool in policy** to encourage employment and increase the economic independence of low-salaried workers, **in addition to other policy means** on the employment market or in the support system. Examples of these policy means include tax credits like the Earned Income Tax Credit (EITC) programme in the USA, reducing direct taxation on low wages, back-to-work grants, a wage subsidy given directly to the worker or a subsidy to employers, vocational training and work-support services. Minimum wage as a sole instrument has limited influence on reducing poverty and disparities or on making it worthwhile to work. In contrast, however, **combining a number of policy means is likely to help to increase their effectiveness** when it comes to attaining social goals, and at the same time to weaken the drawbacks that characterize them. Although minimum wage may have a negative effect on employment, it certainly has advantages compared with other policy means such as “negative income tax” (EITC) or a wage subsidy. For example, the cost to the State budget is incomparably lower, and it does not increase marginal tax on labour. Similarly, it is likely to raise workers’ morale and motivation and hence increase their productivity. It is also likely to reduce public expenditure on the support provided on

the basis of income tests. While a minimum wage is likely to reflect an alternative to higher wages and lower employment, “negative income tax” is likely to reflect lower market wage rates with higher employment levels. At the same time, it should be remembered that the extent of EITC’s positive effect on employment (the aggregate effect on participation in the workforce and on the number of employee hours) is not clear in advance, even if it is agreed that it does not have a negative effect on employment. Research has shown that this policy means has a positive effect on employment and poverty, particularly of single-parent women.

It must be stressed that the argument is not over the necessity for the minimum wage, but whether it should be increased or whether, rather, resources should be allocated to other programmes which might be more effective in achieving goals in the area of employment and inequality. This argument figures prominently in the American public debate in the matter. In practice, the policy adopted in the **USA** in recent years testifies to the **use of both means – increasing the minimum wage and expanding the EITC programme.**

**England** can also provide an example of the use of a number of tools to encourage employment and reduce poverty among workers, particularly families with children: **in addition to minimum wage legislation, negative income tax has been introduced and children’s allowances have been increased.**

Finally, in 2006-2007 a decision was taken in **Israel** to **increase the minimum wage** to a level higher than that stipulated in the original legislation – albeit only temporarily – as well as to **gradually introduce a kind of EITC programme for families with children and people aged 55** and above. It should be stressed that other tools which do not relate to the employment market can also be applied, such as children’s allowances. If increased, these can act as a supplementary measure to other State-level means. The financial support system has a marked effect on limiting poverty among the working-age population. An international comparison points to a strong positive correlation between poverty aspects among workers and generosity of the welfare system measured in terms of the proportion of national product spent on welfare.

**Table 1: Minimum wage in European Union member states**

		Legal minimum wage					Unemployment rates 2006
		Monthly minimum wage in July 2007* T (i)		Minimum wage per hour Sept. 2007**	Minimum wage relative to average income 2005	% of full-time workers earning minimum wage 2005	
		Euros	Converted to purchasing power equivalents (ii)	Euros	%	%	
1	Luxembourg	1570	1503	9.08	50.73	11.00	4.7
2	Ireland	1403	1141	8.65	52.00	3.30	4.4
3	Britain	1361	1292	8.20	36.95	1.80	5.3
4	Netherlands	1301	1244	8.08	45.50	2.17	4.5
5	Belgium	1259	1203	8.08	40.00		8.2
6	France	1254	1150	8.44	47.00	16.80	9.1
7	Greece	668	768	3.80		..	8.9
8	Spain	666	725	3.42	40.44	0.75	8.5
9	Malta	585	805	3.46	50.59	1.45	7.3
10	Slovenia	522	701	3.12	45.55	2.80	6
11	Portugal	470	546	2.41	40.52	4.65	7.7
12	Czech Rep.	288	465	1.76	39.10	2.00	7.1
13	Hungary	258	423	1.51	38.15	7.95	7.5
14	Poland	246	389	1.43	33.66	2.86	13.8
15	Estonia	230	362	1.38	33.15	4.80	5.9
16	Slovakia	217	351	1.46	34.44	1.66	13.4
17	Lithuania	174	324	1.21	38.25	10.34	5.6
18	Latvia	172	310	0.99	33.57	11.95	6.8
19	Romania	114	204	0.66	32.60	9.70	7.3
20	Bulgaria	92	216	0.53	49.64	16.00	9
		<b>Minimum wage under collective agreements</b>					
		% of those employed according to collective agreement out of total numbers of salaried workforce***					
21	Austria	Above 90%, goal by 2009: 100%, the minimum wage is then supposed to be no less than €1,000 a month on the basis of 14 monthly salaries a year					4.7
22	Denmark	82%-92%					3.9
23	Finland						7.7
24	Sweden						7.1
25	Italy	70%					6.8
26	Cyprus	68%					4.5
27	Germany	65%					10.2

\* Source: Eurostat.

\*\* Source: Wirtschafts- und sozialwissenschaftliches Institut der Hans-Böckler-Stiftung.

\*\*\* Schulten, Thorsten und Watt, Andrew (2007), „European Minimum Wage Policy – A Concrete Project for a Social Europe“, European Economic and Policy Brief, 2/2007, Brussels: ETUI-REHS  
(i) In cases where the minimum wage is paid in more than 12 salaries a year (for example in Spain, Portugal, Greece and from 2009 on in Austria as well, the minimum wage is paid in 14 annual salaries a year), the figures have been adjusted to this situation; (ii) Not final.

**Table 2: Minimum wage in the USA, Japan and Israel**

	<b>Legal minimum wage</b>				
	Monthly minimum wage in July 2007* (i)		Minimum wage per hour Sept. 2007**	Minimum wage relative to average income 2005	% of full-time workers earning minimum wage 2005
	Euros	Converted to purchasing power equivalents (ii)	Euros	%	%
<b>USA</b>	676	676	4.23	33.0	1.3
<b>Japan</b>	774	669	4.84	28.0	–
<b>Israel</b>	636	889	3.52 (4,92 converted)	42.0	12.7

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\* Source: Eurostat

(i) In cases where the minimum wage is paid in more than 12 salaries a year (for example in Spain, Portugal, Greece and from 2009 on in Austria as well, the minimum wage is paid in 14 annual salaries a year), the figures have been adjusted to this situation

\*\* Source: Wirtschafts- und sozialwissenschaftliches Institut der Hans-Böckler-Stiftung