

LOCATION DECISIONS AND MINIMUM WAGES

Isabelle Méjean & Lise Patureau

NON-TECHNICAL SUMMARY

The impact of labor-market institutions on macroeconomic performances lies at the heart of current debates among both economic and political circles. Debates are particularly vivid in Europe, where countries have implemented various labor-market policies over the last decades to cope with high levels of unemployment. In particular, as underlined by Dolado, Felgueroso and Jimeno (2000) and Dickens, Machin and Manning (1999), there has been a considerable resurgence of interest regarding minimum wages, which are an important feature of a large number of OECD labor markets.

When asking for the impact of minimum wage policies, two broad and opposite arguments emerge. On the one hand, high minimum wages prevent flexibility on the labor market, and by raising marginal costs, lead to adverse effects on labor demand and employment. On the other hand, minimum wages help maintaining the purchasing power of low-skilled workers and sustaining aggregate demand. Review of the vast labor-market literature devoted to this question yields contrasted results in terms of labor-market performances. The adverse effect of minimum wage obtained in the neoclassical model is questioned in non-competitive frameworks, as shown by Bhaskar and To (1999) in an oligopsonistic model, Cahuc and Zylberberg (1999) in a search-equilibrium model, Manning (1995) in an efficiency wage model or Cahuc and Michel (1996) in a training-enhancing framework. The related empirical literature does not reach a clear-cut conclusion either¹. But in any case within that strand of literature, reasoning is held for a given production structure, thereby neglecting the key role of endogeneity in firms' location decisions. Contrasting with the existing literature, the present paper takes into account this latter dimension by studying the impact of minimum wage policy on country's attractiveness for investors. To this aim, wage rigidities are introduced in a two-country model analyzing firms' location choices in an international setting. Minimum wages at once affect the relative cost of producing and aggregate demands. However, because of international trade costs, firms located

¹ Papers that focus on "natural experiments" do not get any clear-cut impact of minimum wage shocks on employment (See Card and Krueger (1994) for the US, Machin and Manning (1996) for the UK, and Dolado et al. (1996) in several European countries). Yet, empirical papers on individual data most obtain a significant (and negative) impact of minimum wage on the specific segment of lowskilled workers (see Kramarz and Philippon (2001), Portugal and Cardoso (2006), Laroque and Salanié (1999)).

in the domestic country benefit more than their foreign competitors from the demand increase (a phenomenon called “home market effect”).

We show that several conditions must be achieved for the country’s attractiveness to rise with an unilateral minimum wage increase, i.e. for the aggregate demand impact (the “home market effect”) to dominate the negative cost effect in firms’ location choices:

- ✓ the purchasing power gain of unskilled workers (paid at the minimum wage) has to be less than compensated by a reduction in the demand for unskilled labor. This notably requires skilled and unskilled workers to be weak substitutes.
- ✓ the minimum wage increase should not come along with a too substantial drop in skilled workers’ wage. The purchasing power gain on the unskilled labor segment would therefore be compensated by an opposite adverse effect on the other strand of the labor market (i.e. the skilled-labor one), notably if the share of skilled workers in the population is large enough.
- ✓ international trade costs have to be large enough for the “home market” effect to play its role.

Our results suggest that the globalization process, by reducing barriers to trade, tends to reinforce international social competition. While increasing the mobility of production factors, it introduces new constraints in the design of economic policy, that should be taken into account when trying to maintain national competitiveness.

J.E.L. Classification: F12, F16, F21, J31, F41

Keywords : Minimum wage, home market effect, firms location decisions