



The European Commission Mutual Learning Programme

DG Employment, Social Affairs and Inclusion

Key policy messages from the Peer Review on the 'Introduction and implementation of the National Minimum Wage'

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1. Executive summary

This report summarises the key policy messages from the Peer Review hosted by the **UK Department of Business, Innovation and Skills** on the 7-8 April 2014, as part of the Mutual Learning Programme.

The event brought together government representatives and independent experts from **Belgium, Germany, Greece, Ireland, Italy, Latvia, the Netherlands and Norway**, as well as representatives of the European Commission, Eurofound and the ILO.

The Peer Review focused on the introduction and continuous review of national minimum wage provisions and their impact on wage trends, employment and economic developments.

Introducing and implementing the National Minimum Wage (NMW) in the UK: From controversy to broad level support for the principle of setting a minimum wage floor

The Low Pay Commission (LPC) in the UK was set up in 1997, following a period of increasing income inequality across the UK, due to a number of factors. Trade unions had lost their influence since the 1980s, as reflected in declining membership density and collective bargaining; and in 1993 wages councils were abolished after having seen their coverage decline over the year.

From the outset, the LPC had broad terms of reference, including making a difference for the lowest paid workers, and at the same time 'making work pay'. When the NMW was introduced in 1999 (legally based on the 1998 National Minimum Wage Act), it provoked controversy and predictions of dire economic consequences. The NMW was introduced with caution to assess whether it would have negative effects on employment rates, and with a view to be able to catch up later. Introducing the NMW did not have the 'feared' negative impact on employment; by contrast, and unexpectedly, the NMW quickly gained popular and political acceptance, and has remained unchallenged through changes in government.

The LPC functions as an independent body which is responsible for developing recommendations to the government on wage setting in the UK. It consists of nine commissioners (three from employer backgrounds; three from employee backgrounds, and three independent). They are not mandated by their respective organisations, as they are appointed as individuals – thus, the LPC does not comprise a collective bargaining process as in other countries.

The objective of the UK NMW is to prevent exploitation and not poverty (as in some countries); it acts as a policy tool in concert with other measures aimed at ensuring a minimum standard of living (such as the tax and benefit system). In the years between 1994 and 2008 the UK experienced economic growth and low unemployment rates, thereby facilitating annual increases of the NMW. The economic crisis from 2008 challenged the annual increases, and whilst the NMW has maintained its relative position since 2008, there has been a decline of its real value. Given the current improving financial circumstances, increases in the adult NMW rate have now been recommended. As mentioned by the LPC representatives, it was difficult to decide to increase the adult rate and maintain the rate for young people. This was however considered necessary as a means to improve the labour market position of young people by supporting their employability, from the employers' perspective. The UK government refused to follow the LPC recommendation on lowering the apprenticeship rate, however.

The National Minimum Wage in the UK: an overview

- *Target group:* The UK NMW covers all workers regardless of employment contract; excluded groups of workers include, for instance, the Armed forces, prisoners and fishermen.
- Rates are age-differentiated with a rate of 62% of the full rate for 16-17 years old and 83% of the full rate for 18-21 years old. The apprenticeship rate is 42% of the full rate.
- *Scope:* same hourly rate country-wide, all sectors.
- *Objectives:* setting a wage floor (setting a 'living wage' is not the objective of the NMW)
- *Leading organisation:* Department for Business, Innovation and Skills, Low Pay Commission

The LPC is considered to be an example of a successful social partnership in the UK. This in particular lies in the consensus amongst commissioners which leads to clear-cut decisions and few recommendations - simplicity is considered to be of utmost important. Wage setting in the UK emphasises two aspects:

- **Efficiency.** The NMW has to work on the ground to be effective; and
- **Subsidiarity.** The NMW has to make sense in the UK context where all jobs are equal to the law, and where the NMW is a means to achieve other objectives in the country.

Despite significant research on the impact of the NMW, it has been difficult to identify the impact for individuals; around one million workers are covered by the NMW each year (corresponding to about 5% of the labour force). The NMW does not appear to have had significant effects on employment opportunities, but some evidence suggests that in some cases working hours have been reduced, following its introduction (though nonetheless leaving workers better off overall).

Several difficulties are apparent from the UK's experience of implementing the NMW:

- there is a challenge in obtaining reliable pay data;
- a NMW can discriminate against younger workers and workers marginal to the labour market; and
- compliance with a NMW may be more challenging in weaker economic conditions.

The UK approach to the NMW is characterised by a focus on what employers can pay without job loss, rather than on what employees need. The shortcomings of standard price models of wages have been clear in the UK context, in which it has been useful to acknowledge that workers are in general as productive as their employers permit and that workers tend to be more sensitive to relative than to absolute pay levels. Furthermore, pay comparisons are strongest at a local level and small employers can benefit from externally legitimised pay norms. Particular challenges exist for wage earners just above the minimum wage floor as wages may be compressed.

During the Peer Review the empirical and evidence-based approach used by the LPC to set forward recommendations was highlighted as good practice, and all participants agreed that the thorough research undertaken by the LPC provides useful learning for other countries.

Learning outcomes for peer countries in particular include the evidence-based approach applied by the LPC. As emerged in the discussions, wage setting mechanisms are highly contextualised and must be seen in connection with a range of

other policy tools in the country. Hence it is important to make clear the objective of a NMW, what it tries to achieve and in which policy context it operates.

Key messages from the Peer Review

The key policy messages for designing and implementing a national minimum wage and assessing its impact can be summarised as follows:

- It is essential, in considering **implementation of a NMW and determining its level**, to take account of the context within any given country. Thus, how transferable the success factors will be from the UK to other countries, depends very much on the context of wage-setting, collective bargaining and political aspects.
- Furthermore, it is important to understand the **specific objectives of a NMW**. It is unhelpful to regard the NMW as a goal in itself; rather it should be seen as a tool to achieve other objectives. In some countries, the NMW is set to ensure a 'living' wage. As noted earlier, this is not the case in the UK, where the NMW is set to act a wage floor to prevent exploitation of low-paid workers. Other policy measures (in particular, the benefits system) can be used to support living incomes.
- There are various **mechanisms for implementing and operating a NMW**: as noted earlier, in the UK there is an independent body with a role to advise government; other countries rely upon collective bargaining (with negotiation between social partners) to reach agreement on minimum wage levels; and, in some countries, the NMW is set by government with some form of consultation with social partners. The UK approach has limited transferability, since it is unlikely to be appropriate within a tradition of widespread collective bargaining. However, the evidence-based approach used in the UK is of interest in other countries and is transferable.
- **Annual (or other, periodic) review of the NMW level** can be based on a formula (e.g. in line with cost of living changes, or in line with wages, etc.) or – as is the case in the UK – can be a qualitative judgement using a range of data and analyses. The non-formula approach relies upon a consensual agreement; in the UK, this is achieved by acceptance of the role and independence of the Low Pay Commission.
- With regard to **compliance with a NMW**, it is important to acknowledge the difficulty of measuring the effective paid rate for employment (taking into account non-payment of hours worked, for example). The simplicity of the UK NMW facilitates compliance and aids its enforcement.
- There is great variation between countries with regard to **enforcement of the NMW**. Some countries carry out systematic reviews to detect non-compliance with the NMW by employers. In other countries, there is greater reliance upon individual employees to enforce their entitlement to the NMW. In all cases, it is clear that proactive enforcement and provision of information on rights and obligations are very important.
- **The impact of the NMW** is well-understood in the UK context. Impact is usually measured in terms of employment effects, including wage/non-wage costs, working hours and wage compression. An important aspect is how to set the NMW to avoid wage compression to a level just above the NMW.

More information on the Peer Review and background material (including a Thematic Paper, a Host Country Discussion Paper and Peer Country Comment papers) can be found [here](#) on the website of the [Mutual Learning Programme](#).

2. Minimum wage setting in the European Union

The European Commission has promoted decent and sustainable wages to address social imbalances and support demand at the margins. In this way wages and wage distributions are key aspects of the Europe 2020 employment social cohesion targets. Although national wage setting mechanisms are outside the direct remit of the European Union, a number of developments have committed Member States to wage restraint and decentralisation of collective bargaining through, for instance, the EU Economic governance measures to enhance economic and fiscal surveillance.

To support competitiveness across Member States, the Euro Plus Pact (adopted in March 2011) has aimed at enhancing the stability of public finances, reinforcing fiscal stability and fostering employment, for instance through the introduction of flexicurity measures, labour tax reforms and investment in lifelong learning. The Euro Plus Pact was signed by all Euro-zone countries, as well as Bulgaria, Denmark, Italy, Latvia, Lithuania, Luxembourg, Poland and Romania; and Belgium and Cyprus¹ have received country specific recommendations with regard to their wage setting systems since 2011. Also the Economic and Monetary Union (the EMU) has led to increased focus on the role of wages as a policy instrument (Eurofound, 2000). The reform of the Stability and Growth Pact was adopted in December 2011 and includes six directives and regulations on budget deficits, spending levels, and tax levels, aimed at safeguarding financial stability through effective preventative surveillance.

The above-mentioned developments have been described as leading to a 'new system of economic governance' (Schulten and Muller, 2013) whereby national autonomous collective bargaining systems are influenced by political intervention by the EU into national collective bargaining procedures. Social partners have expressed concerns about this development and the continued free collective bargaining.

Several labour market trends have led to an increase in the importance of the minimum wage (MW) to ensure protection of workers. These include, for instance: lower wages to EU migrant workers; concerns about 'social dumping'; new forms of employment contracts such as limited hours part-time work, temporary jobs and 'atypical' contracts (e.g. zero hour contracts); and issues around in-work poverty across Member States.

Following the European Semester of economic policy coordination, the European Commission brought forward recommendations on the need to ensure that wages support competitiveness and develop in line with productivity; that wage setting systems are reviewed in consultation with social partners, and that wage indexations systems are reformed. France for instance received a recommendation to 'make sure that the level of the minimum wage supports job creation and competitiveness'; and Germany received a recommendation on ensuring that wage growth supports domestic demand.

Eurofound, in a recent report (2014), describes the MW as "...a cornerstone of the 'European Social Model'" (p. 5), and emphasises the importance of a MW in social policy. Through the MW, issues such as wage in-equalities and in-work poverty can be addressed; incentivising people outside employment to work is also an important aspect of raising labour supply. As stressed during discussions in the Peer Review, there are however limits to the scope of a NMW; a NMW may be one tool to solve wage-inequalities and in-work poverty, but it has to go hand-in-hand with other policy tools to reach the full effect.

Table 1 provides an overview of wage setting mechanisms in the EU Member States.

¹ No recommendations were made for Cyprus in 2013

Table 1: Overview of minimum wage-setting mechanisms in Member States

	Coordination Type		Coverage	
	Statutory regulation	Collective agreement	National	Sectoral/Occupational
Austria		X	X ⁶	
Belgium		X	X	
Bulgaria		X	X	
Czech Republic	X		X	
Croatia	X		X	
Cyprus	X			X
Denmark		X		X
Estonia		X	X	
Finland		X		X
France	X		X	
Germany (to 2015)		X		X
Greece		X	X	
Hungary	X		X	
Ireland	X		X	
Italy		X		X
Lithuania	X		X	
Luxembourg	X		X	
Latvia	X		X	
Malta	X		X	
Netherlands	X		X	
Poland		X	X	
Portugal	X		X	
Romania	X		X	
Slovenia	X		X	
Slovakia		X	X	
Spain	X		X	
Sweden		X		X
UK	X		X	

Source: Adapted from Schulten, 2012a in Eurofound, 2014

As shown in Table 1, 21 of the 28 Member States have a NMW, whilst 12 member states have wage setting systems based on collective bargaining (this includes Germany which will introduce a NMW in 2015). A small majority of Member States have thus introduced a NMW, although the definitions, objectives and implementation

2.1 Wage floors or living wages?

A particular discussion during the Peer Review concerned the scope of the NMW, and whether it should act as a wage floor or a living wage. The UK and Ireland for instance have wage floors which do not ensure living wages on their own (but should be considered in the context of the wage, tax and benefit system), and from 2015 Germany will introduce a NMW based on a wage floor; in Germany this will, however, be with a view to stimulating collective bargaining for potentially enhanced sector specific minimum wages.

The question was raised about the extent to which a living wage underpins a MW, and it was mentioned that the notion of adequacy does underpin the setting of minimum wages. Although a wage floor is intended to prevent exploitation, the difference between a minimum wage based on the wage floor or on exploitation may be unclear. In the Netherlands for example, the NMW is based on a calculation of the living wage to ensure decent living standards. From the perspective of the ILO it also remains clear that a MW should take into account the level of living wages as an indicator, and be adjusted regularly – this also aligns with the ILO concept of decent work. Defining a living wage would, however, raise issues about what to include in ‘decent living standards’; the Living Wage Foundation in the UK for example includes specific items that people need to afford to have a decent living wage. In the UK, regional

differences are also of importance when calculating a living wage (in London housing is very expensive, and in Scotland food is relatively more expensive). However, in setting the MW, regional distinctions have been avoided in most countries, partly because wage differences can be more significant within a region than between regions.

The scope of the minimum wage is highly dependent on the wider policy context in the country, and that wage policies alone cannot solve problems of austerity and combat poverty, but must be supported by a range of measures. In the Dutch wage setting system the NMW is closely interlinked with the welfare system. A paradox in the Dutch instance may be that it is assumed that people work full-time - and in the Netherlands there is a high proportion of part-time workers. In the UK the welfare system is managed separately from the wage setting system, and the living wage is separate to the NMW.

No definitive conclusion on the question of living wages versus wage floors was reached, although many participants agreed that some kind of consideration of the living wage should be integrated into the definition of the minimum wage.

3. Finding the right level: mechanisms for setting and reviewing the NMW

In the **UK**, setting the level of the NMW is based on **evidence**, and is not a formula-driven approach. Evidence is produced (primarily by the LPC) through research on the impact on the NMW so far and the state of the economy and its prospects, as well as widespread consultation with key stakeholders across the country.

The LPC uses evidence derived from: in-house analysis; commissioned and independent research; consultations; on-site visits; meetings with stakeholders; and review of international developments. The work of the LPC runs on an annual cycle starting between April and June when the government requests the LPC to review specific issues when developing recommendations on the NMW for the following year. Afterwards the LPC considers the research to be carried out and tenders for it. The period between June and October forms a consultation period where LPC Commissioners carry out visits across the UK, as well as receiving written presentations. Following the consultation period, briefing papers are prepared, and formal oral hearings take place in November. In December the LPC discusses the gathered evidence and draws up its recommendations which are presented in a report to the government by the end of February; the government then considers the recommendations in March and April, and decides whether to accept them.

The **Netherlands** has had a NMW since 1968 which is adjusted twice a year. The NMW is based on calculations of a decent income – the Dutch NMW may in this way be defined as a living wage. Minimum wages are based on age, and the rate for young people is known to be exceptionally low. Apart from the NMW the Netherlands also has collectively agreed minimum wages. Previously, these exceeded the NMW significantly, but now the collectively agreed minimum wages are just above the NMW, in order to stimulate employment.

In **Latvia** there have been several approaches in setting the minimum wage, a "moving-target" approach used in 2003-2010 has been replaced in 2011 by an approach which is closer to the UK practice. One of the key differences is that the initial minimum wage proposal is defined by a group formed by representatives of three Ministries and then discussed in the National Tripartite Council. In recent years, the austerity approach used in budgeting has severely limited the options of the authorities. The increases in tax rates and reductions in the non-taxable allowances have become a negative contributing factor in the debate on the changes in the minimum wage².

In the pre-crisis **Greek** system, social partners agreed, at national level, on the setting of the minimum wage. This served as the minimum increase to be granted in other agreements as well. Since the beginning of the economic crisis, a number of structural reforms have been introduced with a particular emphasis on MW policy and Employment protection legislation (EPL). The National Collective Agreement 'EGSEE' was suspended, sectoral agreements were not renewed and bargaining was delegated to the company level. The determination of the MW is now by government decision. Some preliminary indications based on the evolution of the unemployment rates (total, gender and youth) seems to question the success of the MW reform in terms of containing the deterioration of labour market conditions³.

In the **UK**, the LPC has studied the development of the NMW and compared what its rate would have been using different formulas (cost of living increase, increase in line with median earnings etc.) compared to its actual rate of increase using the evidence

² Jakobsons, A (2013), Peer Country Comments Paper – Latvia; Does a similar approach lead to similar outcomes?. Prepared for the Peer Review on 'Minimum Wage', London, 7-8 April

³ Fotoniata, E (2013). Peer Country Comments Paper – Greece; Minimum Wage: Blame or Cure for the Crisis. Prepared for the Peer Review on 'Minimum Wage', London, 7-8 April

based approach. This assessment found that the UK NMW had increased more using the evidence based approach than it would have done using a formula.

4. Enforcement of national minimum wages: an individual or institutional responsibility?

In the **UK** Her Majesty's Revenue and Customs (HMRC) is responsible for enforcement of the national minimum wage. Enforcement has been based in particular on intelligence and exchange of information between enforcement bodies, as well as education, for instance through awareness raising activities. The implementation of the NMW in the UK has consistently been kept as simple as possible (c.f. a small number of age-related MW rates, with no sectoral or regional differentiation). This simplicity in itself means that detection of non-compliance is more straightforward.

To detect non-compliance in the UK, the focus has been on addressing systematic problems through risk assessments. Penalties have been increased, and will increase further as a result of being linked to the number of employees, rather than per business. A helpline exists to allow for individual referrals; all of which are investigated.

Working time constitutes a particular challenge for enforcement of the NMW in the UK, given that the NMW is based on an hourly rate. For instance in the care sector, the time for transportation between clients may need to be counted as working time, and hence included in the calculation of a person's wage; this, however, is not always the case.

Given the wage setting system in **Germany**, employers have taken on a responsibility to pay minimum wages. In this context, the introduction of a NMW may have an impact on employers' attitudes toward their responsibility to pay living wages.

In the **Netherlands** the labour inspectorate investigates large and systematic violations. If individuals have concerns about low pay, they need to raise them with their employer or union. Information campaigns have been used to ensure that individuals are fully informed. The information materials have been translated in different languages to support migrant workers.

Due to a number of difficulties such as a high number of 'envelope' wages and high incidence of tax evasion, it is regarded as difficult to enforce a NMW in **Latvia**. In **Greece** the labour inspectorate tackles non-compliant employers. **Italy** has a high number of SMEs which are difficult to reach and control, in particular with regard to the reporting of working hours, and hence the payment of minimum wages.

5. Impact of national minimum wages

Impact is typically measured in terms of employment effects, including wage/non-wage costs, working hours and wage compression. Estimates of longer term impacts of the NMW are hypothetical as counterfactual analyses are difficult to conduct.

The most pronounced impact seems to have been on working hours (in the UK the NMW is based on an hourly rate), and that the number of working hours have been reduced and standardised.

Given the fact that the NMW in the UK benefited low-paid workers, women in particular benefited from the introduction of the NMW. Two thirds of those who benefited were women (and two thirds of the women were part-time workers). This significantly contributed to a decrease in the gender pay gap. In the Netherlands migrant workers especially benefited from the NMW.

The impact of the NMW on employment is a disputed issue as it may be tempting for employers to cut labour costs following the introduction of a NMW. Existing evidence however suggests that the introduction of a NMW does not have a significant impact on employment (Card and Krueger, 1995; 2000, Allegretto et al, 2011, Dolado et al, 1996; Vaughan-Whitehead, 2010). At the same time the evidence indicates that productivity is proportional to wages, and that productivity benefits from higher wages (Schmitt, 2013). Productivity is, however, a question of business model (labour intensive or capital intensive) and a sectoral question; for instance in the UK care sector, productivity means a reduction in service. As highlighted during the Peer Review higher wages can also stimulate better management.

The general wage structures in an enterprise may be affected by the introduction of a NMW. Wage compression to just above the NMW level has been identified; this constitutes a challenge as there are no policies targeted at those workers who earn wages just above the minimum level. The NMW has thus not necessarily led to a ripple effect in wage structures. Ripple effects have mainly developed in countries with wage setting systems based on collective bargaining and with a strong skills structure and a good opportunity for individual bargaining at company level (Denmark for instance has a strong skills structure and well developed opportunities for individual bargaining). Generating ripple effects thus depends on the context.

The NMW may have an impact on boosting domestic demand, although this should be measured in connection with other benefits which may supplement income. Boosting domestic demand through the NMW has in particular been an issue in Germany with a generally large share of low-income workers and issues have been identified around boosting demand. In the UK it is, as would be expected, mostly low-paid workers who have benefitted from the NMW, although wage compression may have impacted the general wage structures. Wage compression tendencies also appear in **Belgium**, although no clear empirical evidence is available. The impact of a NMW on domestic demand remains an under researched field.

Minimum wages and economic competitiveness have received particularly close attention since the global economic crisis, and it is clear that there is a general concern in the EU emerging from the Country Specific Recommendations in the European Semester that if minimum wages increase without any rise in productivity, companies based in the European Union will be put at a disadvantage compared to the EU's global competitors, especially those in labour-intensive industries. Having said that, most competitive European economies tend to have higher, rather than lower, minimum wage levels (for instance, the Nordic countries). A body of research evidence is building up however that increases in minimum wages tend to foster increases in productivity. Analysis of low-paid employment suggests that this tends to be concentrated in trade-intensive industries like manufacturing which means that minimum wages may only have limited impact on international competitiveness in Europe (in the context of the overall decline in such sectors in the

EU). The overall economic impacts appear to reflect whether employers can mitigate potential negative effect on employment levels by compensatory measures – e.g. changing overall pay structures, reducing non-wage costs, passing on the cost in higher prices or lower profits. Exchange rates and inflation will be additional macro-economic compensatory mechanisms when it comes to international competitiveness.

6. Conclusions and Next steps

In conclusion, this Peer Review identified several key aspects of setting and using a NMW that will be of interest to all countries that have, or are considering, a NMW policy.

- The intended role of the MW either as a wage floor or a living wage and its context in the tax and welfare system.
- The method of MW setting and review and its impact. The role of an independent body (in the case of the UK, the LPC), in recommending to government the level (and the structure) of the NMW, was of great interest to those country representatives participating in the Peer Review. The evidence-based approach to setting the NMW level appears in the UK context to have given credibility and legitimacy to the LPC, thereby facilitating stakeholder (employees, social partners, business and government) support for its recommendations.
- The method used at national level will generally depend at least in part on the industrial relations framework.
- The 'simplicity' of the NMW in the UK was of great interest; its simplicity was seen as contributing to compliance with the NMW, as well as to ease of enforcement.
- Impacts of the national minimum wage: negative impacts on employment were considered marginal or non-existent whereas impacts on pay equality, and to some extent poverty reduction were often significant. Wage compression could be an issue particularly in countries without strong systems of collective bargaining.
- Despite their potential to contribute to the reduction of income inequality, there are some things that minimum wages cannot do. It was noted 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 participation. It should be seen as one tool to be combined with supporting fiscal, social security and training and activation measures.

These were among the key issues of interest to participants and further follow up and transfer of experiences on selected items was encouraged. The [Mutual Learning Programme](#) can provide assistance in further processes of exchange.

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