The Effects of the Minimum Wage on Poverty in Korea*

Jiwon Seo** · Jinook Jeong***

Abstracts

The effects of the minimum wage policy have been controversial in Korea with an increasing gap between the rich and the poor since the Asian financial crisis. Most studies in Korea have focused on the disemployment effects of higher minimum wages and the negative effects of the policy in Korea. This study looks at the possible effects of the minimum wage policy on reducing poverty rates, as measured by the number of people who fall under the defined poverty threshold. We utilize a binary probit model to analyze the Korean Labor and Income Panel Study data and find that a higher hourly minimum wage can reduce the probability of an individual falling under the poverty line.

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I. Introduction

As is reviewed by Kennan (1995), the effects of minimum wages are multilateral and elusive. Most previous empirical studies on the
minimum wage policy have focused on its negative effects such as the reduction of employment opportunities for young adults or the reduction of employment benefits and cost of training workers. In fact, in the United States, it has been shown that high school dropout rates have increased as a result of a minimum wage hike.\textsuperscript{1)} These studies have continued since the 1980s and more recent studies utilizing panel data have corroborated such previous results.

In 2011, the Minimum wage Council of Korea raised the minimum wage by 5.1 percent to 4,320 won (about $3.9) per hour. Past studies indicate that raising minimum wages may in fact result in employers reducing their labor force, either downgrading minimum wage earners to the informal sector or just forcing them to unemployment.

There have been many studies on the disemployment effects of raising the minimum wage level in Korea. However, not much evidence is shown to prove the poverty alleviating effects of the policy. With a rising “working poor” class, there are greater implications for policies like the minimum wage law. Immediately after the 1997 Asian financial crisis, Korea’s poor class expanded to include many irregular workers and those in private businesses. Therefore we attempt to analyze the effects of the minimum wage policy on poverty in Korea and focus on whether it can reduce the probability of an individual lying under the poverty line.

\section*{II. Survey of the Literature}

The effects of minimum wage policies have been primarily explained by economic theories based on the Harris-Todaro model. A minimum wage hike in the formal sector will reduce the labor force and push the unskilled laborers into the informal market. With a

\textsuperscript{1)} Anderson and Rawe (2009).