

A Comparative Study of Minimum Wage and Employment in China and in the United States

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ABSTRACT

In this paper, we use regression models to analyze and compare the effect of a change in real minimum wage on employment rate both in China (the largest emerging market) and in the United States (the largest developed country). The longitudinal data we use is from 2000 to 2016 published by both countries. After controlling for unobserved heterogeneities by using the fixed effect estimations, the results show a significant and negative correlation between real minimum wage and employment rate in both countries, with a smaller and weaker effect of real minimum wage in China. It indicates that employment in China is less responsive to a change in minimum wage because of its unique economic system. In addition, We find that the effect of minimum wage on employment rate turns into insignificant in recent years in China since 2008, which is the opposite of and different from the situation in the U.S.

Key words: *minimum wages, employment rate, comparative analysis*

JEL Classification: J31, D23

INTRODUCTION

Motivation

The minimum wage system is a basic wage and social security system that has been utilized by governments to directly intervene in the wages of labor market. In order to meet the demand of the developing market economy and to protect the basic living needs and lawful rights of working individuals and their families, former Department of Labor of China initiated in November 1993 “Minimum Wage Regulations for Enterprises” (Labor Department, 1993) and officially piloted the minimum wage system and the minimum wage standard in 1994. The minimum wage system has now been implemented in all provinces in China. The United States is one of the earliest countries to implement the minimum wage system. In 1938, the United States enacted the national minimum wage act – ‘Fair Labor Standards Act’ (United States Congress, 1938) and set up the federal minimum wage standard in order to ensure the daily life of the poor. As such, the minimum wage system is carried out across the country and is widely used (Jiao D. 2014). The vast majority of the American people who receive minimum wage are young people ranged from 16 to 24 years old.

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China's minimum wage has risen sharply in the past decade amid an imperfect social security system and labor market. The US government is cautious about raising the minimum wage. With the rise in CPI and the advent of the information technology revolution, the adjustment of the US federal minimum wage is characterized by a small increment at slow pace. So, should the minimum wage continue to rise? What effect will a higher minimum wage have on employment rate? How do we achieve an effective combination of a rational level of minimum wage and the promotion of employment?

The effect of minimum wage on employment has attracted extensive attention in academic circles, and its conclusions have always been controversial. The comparative analysis of the effect of the minimum wage on employment in both China and the US has produced few results. In this study, we use a relatively comprehensive panel data to conduct a comparative analysis over the impact of minimum wage on employment rate in both countries, and to seek the difference of the impact and the reasons behind the difference. This study is to perfect the minimum wage system, to improve the quality of employment and the effectiveness of the minimum wage, and to improve the coordination between minimum wage and employment rate. It is believed the study possesses both theoretical significance and practical values.

Historical background

As economy develops and living expenses rises, minimum wage increases gradually. In China, minimum wage has entered a period of rapid and frequent increase since 2004. From 2000 to 2016, the average annual growth rate of the minimum wage in China was 11.3%, and the average wage increased by 13.2%. The minimum wage adjustment in the United States appears to be small and slow; however, the federal minimum wage has risen from \$0.25 per hour in 1938 to the current \$7.25 an hour. From 2001 to 2017, the average annual growth rate of the minimum wage in the US was 2.3%, and the average wage increased by 2.5%.

Research question

What impact will the increase of minimum wage have on employment? What is the difference, between China and America, of the impact of minimum wage increase on employment? What are the reasons for their difference? The study of those questions is the main content of this paper.

This paper is organized in six sections. Section one is about the background and significance of the study. Section two is a literature review which provides the research basis for our study. The third and fourth sections use the panel data from both China and the United States (2000-2016) to evaluate the employment effect of the minimum wage in China and in the United States by using a regression method. The fifth section is the comparative analysis that explains the research results and the reasons for any differences between the two countries. Section six concludes and puts forward policy suggestions.

LITERATURE REVIEW

Researchers have long put forward different opinions on the implementation of the minimum wage system and studied the adjustment and evaluation of minimum wage and its economic effects on employment. They proposed some relative theoretical models and used them to explain how the minimum wage affects employment. At the same time, different evaluation methods were used from a variety of perspectives to empirically test the effect of minimum wage on employment.

In China, Leping Yuan and Gongfei Li (2007) used a model of labor supply and demand to study the increase in minimum wage and concluded that it not only increased the income of the workers, but also reduced the unemployment rate. Guangxin Wang and Xianguo Yao (2014) used the 2000-2010 panel data of 30 autonomous regions in China and took the contracted



employees from various companies as their research object to study the impact of the minimum wage increase. They found a negative effect on the employment of those employees by using Generalized Least Square Method. You Wu (2014) used a differential GMM (Generalized method of moments) method to conduct an empirical study using panel data from 26 regions of China from 1998 to 2012. The results showed that the effect on national employment was negative, but the negative impact on employment could be offset by economic growth. The increase of minimum wage has a significantly inhibitory effect on employment in the north-eastern and eastern regions, while the employment impact in the central and western regions is not significant.

Abowd, Francis & Margolis (2000) found that the overall employment effect of the minimum wage is negative, but there are differences in the degree of employment impact on workers of different genders. Every 1% increase in the minimum wage reduces the employment of American male and female workers by 0.4% and 1.6% respectively.

Sabia & Joseph (2014) studied the employment effect of minimum wage on low-skilled workers in different economic cycles of a country, and the impact of national productivity and spatial heterogeneity on low-skilled sectors. It turns out that the increase in the minimum wage between 1989 and 2012 reduced employment for low-skilled workers more during the recession than that during economic expansion. The employment flexibility range of the national minimum wage is 0-0.2 in the economic expansion, but as high as -0.3 in the trough of the economic cycle.

The study by Neumark and Wascher (1992) found that the minimum wage had a significant negative impact on employment, especially for low-income workers. The increase of the minimum wage by 10% increased the unemployment of American teenagers by 1%-2%, and increased the unemployment of young adults by 1.5%-2%, that is, the increase of the minimum wage reduced the employment of young people.

Kalenkoski and Lacombe (2013) used spatial econometric techniques and the annual average data from 1990 to 2004 collected by the US Bureau of Labor Statistics to check the youths' employment effect of minimum wage. The results showed that youth employment has been affected. The minimum wage increased by 10% in real terms, the youth employment fell 2.1%. Neglecting the spatial correlation will underestimate the impact of minimum wage on youth employment.

Slonimczyk and Skot (2012) conducted a regression analysis on the relative impact of the minimum wage on employment and concluded that the reduction of the minimum wage in the United States may lead to the decrease of employment and the deterioration of the relative wage of low-skilled workers.

It is evident that the research on minimum wage has achieved great outcomes in the past decades. Different data and different methods have been used to study the employment effect of the minimum wage. There is a large amount of studies over the employment effect in China that is created by the minimum wage, but they are mainly on Chinese migrant workers and employment in different regions. Studies on the impact of minimum wage on American youth employment, different gender workers and employment in different states are relatively focused in America. But comparative analysis of the impact of the minimum wage on employment in different countries is rarely fruitful, which provides a research space for this study.

This study uses relevant governments' annual statistical data for the period of 2000 and 2016 and uses the regression analysis to analyze the employment effect of the minimum wage increase in both China and the United States. Through comparison of the results we try to explore the differences between the two countries and the reasons for the differences.

DATA

Data sources

The Chinese data adopted in this study comes from Chinese official statistics including The National Bureau of Statistics of the People's Republic of China, The Ministry of Human Resources and Social Security and The National Federation of Trade Unions and other departments, such as "The Statistical Yearbook of China (2004-2016)", "The Labor Statistical Yearbook of China (2004-2016)", "The Statistics Bulletin of the National Economy and Social Development of China (2003-2016)", as well as the relative annual statistical yearbooks from different provinces, autonomous regions and municipalities directly under the central government and labor law and so on. The U.S. data are mainly from the statistical data and the investigation reports released on the website of the Bureau of Labor Statistics by the Department of Labor.

Those data include the minimum wages and average wages, employment, GDP (Gross National Product), relevant data such as the consumer price index and foreign direct investment. The data are all collected from official agencies, with authenticity and reliability.

Variable selection

There are many factors that can affect employment, such as the economic development speed, wage level, labor supply and demand, and changes in the international economic environment. This study mainly analyzes the effect of the increase of the minimum wage on employment. In the process of econometric analysis, the analysis variables mainly include employment-to-population ratio as a measure of employment rate, minimum wage, average wage, and GDP per capita. The minimum wage, average wage and GDP are then converted into monthly minimum wage, monthly average salary and monthly GDP per capita.

In China, minimum wage level is difference across different provinces, and we use the province level monthly minimum wage documented by The National Bureau of Statistics of China. The American state minimum wage standard form is usually an hourly minimum wage standard, so the hourly minimum wage standard is converted into monthly minimum wage (calculated by using 40 hours a week, 52 weeks in a year, or 12 months in a year) in the process of econometric analysis.

In order to ensure the comparability of the panel data, the minimum wage, average wage, and GDP per capita and so on are converted into the real value by applying the Consumer Price Index with the base year of 2009. In order to eliminate possible heteroscedasticity between variables, the annual time series such as the minimum wages and average wages and GDP per capita are transformed into the natural logarithm.

Summary statistics

Table 1 and table 2 show the descriptive statistics for both China and U.S. between 2008 and 2016. As we can see from table 1, the employment rate in China is slightly higher than the rate in the U.S.; Monthly nominal minimum wage, average wage and GDP per capita are in U.S. dollar values and converted into real values by using the Consumer Price Index with the base year 2009 equal to 100. the real values of wages and GDP per capita is substantially low for China compared to the ones for the U.S. Table 2 allows us to observe the trend of growth of minimum wages, average wages and GDP per capita both in China and U.S.; Column 2 and 3 in table 2 reports the statistics of China before and after year 2008. Column 4 and 5 include the information for the U.S.; With respect to the employment rate and minimum wages (in terms nominal and real values), we observed a large increase in minimum wages in China, which is associated with slight increase of labor employment rate. Yet in the U.S., the trend is the opposite, an increase in the minimum wages is accompanied by a decrease in the labor employment rate. These trends



suggest that the effect of minimum wage on employment in China may not be as sensitive as the effect in the U.S. in an expected direction. As a result, this merits a more detailed regression and comparative analysis. Other variables such as average wages, GDP per capita and consumer price index all keep increasing over time in both countries as we expected.

ECONOMETRIC SPECIFICATION

In this paper, our objective is to estimate the effect of minimum wage on employment indicated by the labor participation rate. In order to accurately measure such effects and given the longitudinal structure of our data, we use the fixed-effect estimation models to control for the unobserved time-invariant heterogeneities. The model specification is as follows:

$$\ln(E_{it}) = C_0 + C_1 \ln(MW_{it}) + C_2 \ln(AW_{it}) + C_3 \ln(AP_{it}) + C_4 t + C_5 \ln(MW_{it}) * \ln(AW_{it}) + \mu_i + \varepsilon_{it}$$

Where employment-to-population ratio or employment rate, E_{it} , is the dependent variable of the province i or state i in year t . We aim to estimate, C_1 , the captures the effect of minimum wage on employment. In the specification above, μ_i is a province-specific effect that stays constant across time and ε_{it} is an idiosyncratic error term. μ_i may include factors such as working cultural or confidence in the economic and political system such as communism that does not vary much with time. Fixed effect estimate models remove the effect of those unobserved time-invariant characteristics so we can assess the net and unbiased effect of the predictors on the outcome variable.

MW_{it} represents the monthly real minimum wage of the province or state i in year t . We assume that the time variant minimum wage in each province is exogenously determined by the local governments in both countries. We converted minimum wages to monthly values in both countries to for the purpose of consistency and performance of comparative analysis.

AW_{it} is the monthly real average wage of a province or state, and it is also time variant and reflects the degree of average income of workers in a certain area and time. It also captures individuals' incentive to work and the average number of jobs employers are willing to offer. AP_{it} is the explanatory variable that reflects the monthly real GDP of a province or state. The growth of the real GDP indicates the economic growth a country or region and the development of an industry that may eventually determine the employment or the labor participation. Other control variables include the interaction term the between real minimum wage and real average wage and time trend. The effect of real minimum wage on employment varies with the real average wage. The time trend is used to illustrate growth in production or industry earnings which also influence the employment or the labor participation.

RESULTS

Table 3 shows the fixed effect estimation results for China and U.S. between 2000 and 2016. As we may observe, minimum wage has significant negative effects on the employment rate or employment-to-population ratio for both countries. However, the effect is significantly smaller for China than it is for the U.S.; More specifically, from the estimate coefficients, we can say that the marginal effect of log real minimum wage is -1.249 in China, which is smaller than the marginal effect of log real minimum wage in the U.S., -3.524. As a result, China's labor force and employment is less sensitive to a change in the minimum wage. Also, by comparing the coefficients of log real GDP per capita, we may conclude that China's employment is more sensitive to a change in GDP than it is for the U.S.

Table 4 describes the estimations result in different time periods for China and U.S. respectively. We use the estimations in different time periods to examine how the effect of minimum wage on employment changes over time. For China, an interesting observation is that the effect is significantly negative before 2008 and then turns into insignificant and weak after

2008. It indicates that the employment is not quite sensitive to an increase of minimum wage in China in recent years probably due to the change of exogenous policies or economic environments. However, in the U.S. we have a different situation, that is, the effect of minimum wage on the labor participation tends to be stronger and bigger in recent years.

In table 5, we perform the estimations at a different range of minimum wage. The effects are estimated on the upper 50th percentile of the minimum wage. We do this in order to see if there is any change of the effect when minimum wage becomes relative higher. From the table, we find that, in China, at the upper range of the minimum wage, the effect of such wage on labor employment does not persist, which may indicate that as the minimum wage increases, the relationship between minimum and employment tends to become weak and insignificant. Again, in the U.S., we have a more stable and consistent situation, the effect of minimum wage is still negatively significant at higher levels of such wage.

Table 6 shows the estimation results in different areas for China. We mainly look at the coastal areas and inner areas of China. Coastal areas are in general more developed than inner area. By comparing the coefficients of the minimum wage, we observe that labor employment is more sensitive to the change of minimum wage in coastal areas where there are more private and foreign invested companies. Labor market and market of goods and services are also relatively mature and open in coastal areas. The effects of other variables such as average wage, GDP per capital and time trend are also significantly bigger in coastal areas.

Table 7 captures the fact that the effect of minimum wage on employment also depends on Foreign Direct Investment (FDI) in China. FDI is associated with the private industries and companies that are not owned and operated by the government. Foreign invested companies in China are sensitive to the change of minimum wage because of the characteristics of cheap labor intensive industries in which most of these companies are involved. On the other hand, state-owned domestic industries are less responsive to the change of minimum wage because they are not sensitive to the cost variations thanks to the government subsidies. The evidence that state-owned industries and foreign invested companies behave differently and that FDI reinforces the negative effect of minimum wage can be found in the estimation results. As the table 7 shows, when the effect of minimum wage is significant between 2000 and 2016, especially before 2008, the interaction term minimum wage and FDI are also significantly negative, which demonstrates the fact that, as the minimum wage increases, its negative effect is further amplified the value of FDI and the number of foreign invested industries.

CONCLUSION

This paper studies the effect of minimum wage on employment measure by the employment-to-population ratio. The analysis over the panel data from 2000 to 2016 shows that the minimum wage is significantly correlated to the employment rate both in China and in the United States. In capitalist economy, raising minimum wage may lead to a decline in employment rate due to the fact that employers are reluctant to hire or keep labor because of the increased cost of labor, which is consistent with the results of our data analysis. However, the magnitude of such effect is different between China and U.S. because their different economic and political systems. From our analysis, a dollar increase in minimum wage in China would reduce employment rate lower than it does in the U.S.; This indicates that the increase of minimum wage in China has a smaller impact on the decline of employment rate, which may be because China's demographic structure, national system and enterprise structure are different from those in the United States. This shows that China's employment may not be sensitive to raising the minimum wage. One explanation could be that China has a large number of state-owned enterprises or companies that are subsidized by the government, and when the cost of employing people increases, these companies are not quite responsive due to the government subsidies. When we divide China into inland and coastal regions, the significant negative



correlation still exist between the minimum wage and employment rate in the both regions. However, coastal regions are more responsive to the change of minimum wage, which may indicate different portions of the state-owned companies in these areas.

When we divide the time into two periods, before 2008 and after 2008, there is an interesting observation in China: before 2008, an increase of the minimum wage significantly reduces the employment rate, but after 2008, an increase in the minimum wage did not significantly lower the employment rate. This may indicated that, after 2008, due to policy uncertainties in China, there may be the withdrawal of foreign invested enterprises or the enterprises relying on cheap labor, or it may because of the upgrades of domestic industries. Some domestic enterprises in China may no longer rely on the labor intensive operations that pay the minimum wage. For the United States, the economy is relatively more stable, and the increase of minimum wage before and after 2008 is always significantly associated with the decrease of employment rate.

In addition, for China, after the minimum wage exceeds a certain level, such as 50th percentile, the increase of the minimum wage has no significant impact on the employment rate. It may be because that an increase in the minimum wage has led to an exodus of foreign firms or firms that heavily rely on cheap labor. The remaining firms are less sensitive to the minimum wage. After we introduce the interaction term between foreign direct investment and minimum wage, we also find the effect of raising minimum wage on the employment rate is dependent on and reinforced by the Foreign Direct Investment (FDI) before 2008. However, raising the minimum wage after 2008 had no such significant effect on the employment rate. Our estimation would be more accurate if the data for the employment rate of foreign enterprises or domestic enterprises are available. In the future, if we could get county level or individual level data, we would be able to perform more comprehensive analysis.

RESEARCH PROJECT

Key research projects of universities in Henan Province (No. 18A790019), science and technology project of Henan Province (No. 172102310710), soft science research project of Henan Province (No. 192400410200).

Table 1. Summary Statistics for China and U.S. 2008-2016

	China 2008-2016	U.S. 2008-2016
Employment Rate	0.661 (0.361)	0.654 (0.068)
Monthly Nominal Minimum Wage	103.420 (58.398)	1176.854 (242.712)
Monthly Nominal Average Wage	375.572 (241.017)	3487.108 (593.755)
Monthly Nominal GDP Per Capita	346.868 (272.323)	3958.465 (987.243)
Monthly Real Minimum Wage	83.224 (38.119)	1183.582 (170.007)
Monthly Real Average Wage	300.829 (166.198)	3477.129 (467.893)
Monthly Real GDP Per Capita	279.592 (203.341)	3978.900 (775.008)
Consumer Price Index (2009 Dollar)	118.436 (16.076)	98.962 (11.537)
Observations	510	504

Table 2. Summary Statistics for China and U.S. Before and After 2008

	China 2000-2007	China 2008-2016	U.S. 2000-2007	U.S. 2008-2016
Employment Rate	0.610 (0.389)	0.707 (0.329)	0.668 (0.064)	0.644 (0.069)
Monthly Nominal Minimum Wage	55.855 (17.779)	145.699 (48.573)	978.575 (158.975)	1335.478 (170.846)
Monthly Nominal Average Wage	183.188 (79.160)	546.580 (204.877)	3049.328 (392.845)	3793.554 (513.289)
Monthly Nominal GDP Per Capita	167.408 (126.938)	506.388 (267.831)	3408.004 (776.037)	4398.833 (915.377)
Monthly Real Minimum Wage	53.425 (15.762)	109.712 (32.128)	1110.457 (171.528)	1242.082 (144.440)
Monthly Real Average Wage	174.836 (71.901)	412.824 (144.639)	3398.805 (462.507)	3532.236 (464.597)
Monthly Real GDP Per Capita	160.127 (119.929)	385.784 (203.487)	3851.122 (771.320)	4081.121 (764.038)
Consumer Price Index (2009 Dollar)	103.933 (4.634)	131.327 (10.745)	88.215 (6.094)	107.560 (6.583)
Observations	240	270	224	280

Table 3. Fixed Effect Estimation for China and U.S. 2000-2016

	China	U.S.
Employment		
Log Real Minimum Wage	-1.249*** (0.190)	-3.524*** (0.700)
Log Real Average Wage	-1.999*** (0.144)	-3.234*** (0.625)
Log Real GDP Per Capita	0.465*** (0.056)	0.229*** (0.023)
Time Trend	0.054*** (0.012)	-0.003*** (0.000)
Interaction Between Real Minimum and Average Wage	0.249*** (0.032)	0.430*** (0.086)
Constant	-102.671*** (23.596)	30.533*** (5.141)
Observations	510	476

Standard errors in parentheses

p < 0.05, **p < 0.01, *p < 0.001*

**Table 4.** Fixed Effect Estimations for China and U.S. before and after 2008

	China<2008	China>=2008	U.S.<2008	U.S.>=2008
Employment				
Log Real Minimum Wage	-1.514*** (0.508)	-0.175 (0.390)	-1.382* (0.795)	-4.136*** (0.886)
Log Real Average Wage	-2.113*** (0.441)	-0.557* (0.306)	-1.361* (0.706)	-3.839*** (0.788)
Log Real GDP Per Capita	0.582*** (0.218)	0.252*** (0.051)	0.240*** (0.023)	0.235*** (0.038)
Time Trend	0.002 (0.033)	0.023 (0.014)	-0.005*** (0.000)	0.001** (0.000)
Interaction Between Real Minimum and Average Wage	0.324*** (0.099)	0.069 (0.066)	0.166* (0.098)	0.508*** (0.109)
Constant	1.731 (64.704)	-46.865* (27.885)	17.697*** (5.784)	26.228*** (6.602)
Observations	240	270	196	280

Standard errors in parentheses

p < 0.1, **p < 0.05, *p < 0.01*

Table 5. Fixed Effect Estimation for China and U.S.

	China Median	U.S. Median
Employment		
Log Real Minimum Wage	0.298 (0.435)	-5.584*** (1.301)
Log Real Average Wage	-0.812** (0.357)	-5.139*** (1.132)
Log Real GDP Per Capita	0.299*** (0.052)	0.232*** (0.028)
Time Trend	0.079*** (0.013)	-0.002*** (0.000)
Interaction Between Real Minimum and Average Wage	-0.021 (0.071)	0.679*** (0.158)
Constant	-159.426*** (26.219)	43.487*** (9.405)
Observations	258	347

Standard errors in parentheses

p < 0.1, **p < 0.05, *p < 0.01*

Table 6. Fixed Effect Estimation for Coastal and Inner Provinces

	All Areas	Coastal Areas	Inner Areas
Employment			
Log Real Minimum Wage	-1.249*** (0.190)	-1.177** (0.460)	-1.011*** (0.215)
Log Real Average Wage	-1.999*** (0.144)	-2.429*** (0.349)	-1.586*** (0.165)
Log Real GDP Per Capita	0.465*** (0.056)	0.607*** (0.156)	0.382*** (0.060)
Time Trend	0.054*** (0.012)	0.098*** (0.026)	0.015 (0.014)
Interaction Between Real Minimum and Average Wage	0.249*** (0.032)	0.236*** (0.080)	0.229*** (0.036)
Constant	-102.671*** (23.596)	-188.518*** (52.063)	-26.656 (27.723)
Observations	510	102	408

Standard errors in parentheses

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

Table 7. Fixed Effect Estimation after the Control of Foreign Direct Investment

	2000-2016	2000-2007	2008-2016
Employment			
Log Real Minimum Wage	-1.443*** (0.193)	-2.636*** (0.500)	0.688 (0.510)
Log Real Average Wage	-2.270*** (0.167)	-3.736*** (0.521)	0.442 (0.489)
Log Real GDP Per Capita	0.417*** (0.053)	-0.031 (0.201)	0.234*** (0.051)
Log Real FDI	0.301*** (0.068)	1.100*** (0.171)	-0.334*** (0.123)
Time Trend	0.048*** (0.011)	0.042 (0.029)	0.024* (0.014)
Interaction Between Real Minimum and Average Wage	0.321*** (0.042)	0.780*** (0.127)	-0.157 (0.108)
Interaction Between Real Minimum Wage and FDI	-0.039** (0.016)	-0.221*** (0.044)	-0.078*** (0.029)
Constant	-91.592*** (22.509)	-74.800 (56.391)	-54.198* (28.299)
Observations	510	240	270

Standard errors in parentheses

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

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Article history:	Received: June 20, 2019
	Accepted: September 19, 2019