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TOO STRICT, TOO WEAK, OR JUST RIGHT? MINIMUM-WAGE REGULATION AND THE FINANCE–EMPLOYMENT–ECONOMIC PERFORMANCE NEXUS IN DEVELOPING ECONOMIES

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Abstract:

This study examines whether the association between financial development, employment and economic performance varies across minimum-wage regulatory regimes in developing economies. It uses an unbalanced panel of 96 countries from 2000 to 2022. The dependent variable is the natural logarithm of real gross domestic product in constant 2015 US dollars; therefore, it measures the real output level rather than the annual GDP growth rate. Financial development is represented by domestic credit to the private sector and broad money, both as percentages of GDP, while employment is measured by the total labour-force participation rate. The analysis combines dynamic System Generalised Method of Moments estimation with Hansen-type panel threshold estimation. The reported estimates show positive, statistically significant interactions between employment and both financial-development proxies. Two significant minimum-wage thresholds are identified for each proxy: 3.617 and 5.133 for the domestic-credit model, and 5.133 and 8.447 for the broad-money model. The intermediate regime contains the most consistently significant positive conditional association. However, because formal equality tests between regime coefficients are not available in the supplied results, the estimates do not establish that its coefficient is statistically larger than every other regime. The threshold pattern remains qualitatively stable under alternative bootstrap and trimming choices and after four outlier countries are excluded. The results indicate institutional contingency rather than a universal optimum and should be interpreted as associations, not causal effects. They suggest that minimum-wage

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policy, access to finance, productivity support and enforcement capacity should be considered jointly, while country-specific causal research is needed before prescribing regulatory targets.

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Keyword:

Developing Countries; Economic Performance; Employment; Financial Development; Minimum Wage; Panel Threshold Regression; System GMM

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Introduction

Financial development and labour-market regulation are usually analysed in separate strands of the development literature, even though firms and workers experience them simultaneously. Financial systems determine whether enterprises can obtain working capital, finance expansion, absorb shocks and invest in productivity-enhancing activities. Labour-market institutions determine the cost and security of employment, the wage floor confronting firms, and the extent to which the gains from growth are shared with workers. In developing economies, where financial constraints, informality, incomplete regulatory coverage and uneven enforcement are common, the growth consequences of one institution may therefore depend materially on the other. A minimum-wage rule that is manageable for a well-financed firm may be binding for a credit-constrained firm; conversely, deeper access to finance can help firms accommodate labour-cost adjustments while preserving investment and employment.

For many years, scholars have contended that financial institutions play an important role in supporting economic success through saving mobilisation, investment screening, capital allocation, transaction costs reduction and risk management (King & Levine, 1993; Beck, Levine & Loayza, 2000; Levine, 2005). However, the empirical link between financial development and economic success is not linear or unconditional. He and Yoo (2024), for example, document a threshold in the relationship between financial development and domestic investment, while Ullah, Zubir, and Ariff (2024) show that regulatory quality conditions the relationship between financial development and economic outcomes. These developments shift the question from whether finance matters to when and under what institutional conditions financial deepening translates into real-economy gains.

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A parallel evolution is evident in minimum-wage research. Evidence from developing economies is heterogeneous because legal coverage, informality, productivity, enforcement capacity and the degree to which the wage floor binds differ sharply across countries. Neumark and Munguía Corella (2021) show that negative employment effects are more likely to emerge when minimum wages are binding, strongly enforced, and evaluated among vulnerable formal-sector workers. Badaoui and Walsh (2022) demonstrate theoretically and empirically why non-compliance can be an equilibrium response among low-productivity firms, while Samutpradit (2024) finds that minimum-wage increases in Thailand shifted some employment from covered to uncovered sectors. More recent evidence from Vietnam and Uruguay also underscores the importance of institutional context: Nguyen (2025) reports limited employment effects but lower working hours in Vietnam, whereas González-Pampillón and Vázquez-Grenno (2026) show that compliance and enforcement capacity shape the effects of a large minimum-wage reform in Uruguay.

The above literatures create a crucial gap. The literature on minimum wage looks at the impact of the wage floor on wages, employment or hours; the literature on finance growth looks at the impact of finance on output, investment or volatility. There is little evidence on the extent to which minimum wage policy impacts the ability of finance development and employment to drive economic growth. This gap is significant especially for developing nations. An economic policy package which involves liberalizing access to finance while at the same time tightening labour laws can impact growth differently based on how well firms are able to finance their wage bills, labour coverage, enforcement, productivity and adjustment options.

This paper fills this gap by using panel data on 96 developing nations from 2000 to 2022. It focuses on two measures of financial development domestic credit to the private sector (DCPS) and broad money (M3) and asks whether minimum-wage regulation creates distinct regimes in the finance employment growth relationship. The empirical design proceeds in two stages. First, a dynamic panel GMM framework establishes whether employment conditions the contribution of financial development to growth. Second, Hansen-type panel threshold estimation allows the data to determine whether the conditional effect changes at endogenous minimum-wage cut-offs. The threshold variable is the minimum-wage regulation measure reported in the Fraser Institute's Economic Freedom data. Following the thesis coding, lower values are associated with stronger minimum-wage regulation and higher values with weaker regulation; the resulting regimes are described as high, moderate and low enforcement/intensity. Because this index is not a direct administrative measure of inspections or penalties, the enforcement interpretation is used cautiously and is revisited in the limitations section.

The findings yield a clear non-linear pattern. The GMM results show that employment by itself is not a statistically robust driver of growth in the preferred specification, but its interactions with DCPS and M3 are positive and significant. The threshold analysis then identifies two statistically significant cut-offs for each financial-development proxy. For the DCPS employment channel, the cut-offs are 3.617 and 5.133; for the M3 employment channel, they are 5.133 and 8.447. Across both models, the intermediate regime produces the most consistently favourable statistically significant conditional growth effect. The result survives sensitivity checks using alternative bootstrap replications and trimming percentages, as well as re-estimation after excluding Panama, Oman, Samoa and Vanuatu as outliers.

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The study makes three contributions. First, it extends the finance growth literature by treating labour-market regulation as a conditioning institution rather than an external policy background. Second, it extends the minimum-wage literature beyond the conventional employment-versus-wage trade-off by examining how wage regulation interacts with finance and employment in shaping macroeconomic growth. Third, it provides a policy-relevant non-linear result: the estimated relationship is consistent with the view that neither the most stringent nor the weakest regulatory regime is automatically optimal. Instead, the growth contribution of finance and employment appears strongest under a calibrated middle regime. This finding fits the policy orientation of research that stresses the difference between de jure regulation and effective implementation (Kanbur & Ronconi, 2018) and the importance of institutional capacity in developing economies.

The remainder of the paper is organised as follows. Section 2 reviews the theoretical and empirical literature and develops the study's hypothesis. Section 3 describes the data, variables and econometric strategy. The results of GMM and threshold along with the robustness tests are shown in Section 4. The findings are explained in the context of finance theory, labor market theory, and regulation theory in Section 5. The policy implications are drawn out in Section 6.

Literature Review and Analytical Framework

Financial Development and Economic Performance

The theory behind the positive effect of finance on growth is based on the ability of financial markets and institutions to mitigate the problems of information and transaction cost. Finance through savings mobilization, screening of borrowers, supervision of investments, diversification of risks, and exchange can increase the amount and quality of investments and thus lead to growth (King & Levine, 1993; Beck et al., 2000; Levine, 2005). The effectiveness of savings in the production of investments can have an impact on growth in the context of endogenous growth models.

As far as developing economies are concerned, the role of this process is even more significant because private businesses often find themselves constrained in credit and rely extensively on their financial sectors. Domestic credit to private sector provides one measure of intermediation – the degree to which banks allocate funds to private economic activity. Broad money, in turn, provides the measure of monetary and deposit depth, showing the liquidity base on which transactions and intermediation take place. The accepted thesis demonstrates positive correlation between both variables and GDP in the dynamic panel analysis, especially in the case of DCPS.

However, it is important to note that more recent studies have found that there are no guarantees that there will be a monotonic effect. Financial expansion without adequate regulations may lead to misallocation, fragility, or speculative investments. He and Yoo (2024) found an inverted-U-shaped relationship between financial development and domestic investment while Ullah et al. (2024) have shown that regulatory quality acts as a moderator of the finance-growth and finance-volatility relationship. This finding is significant to the present research as it implies that financial development should be studied together with institutions.

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Employment as a Transmission Channel

Employment serves as a natural link between the two concepts of finance and economic growth. Companies that suffer from financial constraints may not engage in profitable activities due to lack of financing of their stocks, capital goods, and payroll costs. With increased availability of financing, companies will be able to increase their output level and employ additional workers, who in their turn will provide labor and incomes that will contribute to aggregate demand. Such an approach is in line with neoclassical and endogenous growth theories.

Yet, the connection is somewhat more complicated than a mere positive employment coefficient. The number of labour force participants may increase without proportional increase in output if the employment is informal, non-productive, underemployment, or mismatched. These results from the thesis confirm the idea: employment itself is insignificant in the preferred GMM model, while the interaction of employment and DCPS as well as M3 is positive and significant. The reason for this is that what is important is not only the amount of labour supplied but the ability of the financial system to put it to productive use.

This interaction theory further explains the threshold exercise. If there is complementarity between employment and finance, then any form of regulation that has an impact on the cost of employment would affect the degree of complementarity. While the introduction of a wage floor that increases household income can contribute to consumption and productivity, the problem comes when the wage is overly restrictive relative to productivity and firms have no ability to adjust their financing structure.

Minimum Wages Compliance and Enforcement in Developing Economies

Minimum wages are intended to protect low-paid workers, reduce wage inequality and establish a socially acceptable floor to compensation. The classical competitive model predicts that a binding wage floor can reduce labour demand, whereas monopsony models allow a moderate minimum wage to raise both wages and employment when employers possess wage-setting power. In developing economies, the empirical predictions are further complicated by informality, weak coverage, imperfect enforcement and large productivity differences across firms.

The cross-country review by Neumark and Munguía Corella (2021) shows that estimated employment effects in developing economies are heterogeneous but systematically related to institutional conditions. Negative effects are more likely to appear where the minimum wage is more binding and strongly enforced, especially for vulnerable formal-sector workers. Ham (2018), studying Honduras, finds partial compliance, reduced covered employment and increased uncovered employment following minimum-wage hikes. Samutpradit (2024) similarly reports a contraction in covered low-skilled employment in Thailand accompanied by expansion in the uncovered sector. These studies demonstrate that the relevant margin is often not employment versus non-employment, but movement across regulatory coverage and compliance states.

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Enforcement is therefore central. Kanbur and Ronconi (2018) emphasise the difference between the stringency of labour law and effective regulation, showing that de jure rules and de facto enforcement need not move together. Badaoui and Walsh (2022) show that non-compliance may be economically rational for low-productivity firms and that enforcement mechanisms influence whether statutory minimum wages bind in practice. Recent research further confirms this observation. According to González-Pampillón and Vázquez-Grenno (2026), in Uruguay, the considerable real increase in minimum wages led to significant positive effects in terms of wage growths without any employment loss and, at first, was coupled with weak compliance and subsequent tough enforcement. This finding implies that the impact of minimum-wage policies is conditional not only on the statutory minimum wage rate but also on enforcement and institutional adaptability.

Developing countries' empirical research suggests the same caution about generalising the results. No impact of minimum-wage growth on employment in Vietnam is found by Nguyen (2025). However, the author also observes a reduction in working hours and an increase in hourly wages. The adjustment in working hours rather than in employment demonstrates additional channels for firms' reaction. In such a way, the effect of minimum-wage policy can be different even if the effect on employment is negligible because the other factors change simultaneously.

Why a Nonlinear Regulatory Association Is Expected

Combining finance and labour literatures implies a non-linear hypothesis. With very low minimum wage regulation, the regulation may fail to be strong enough to improve the labour income, incentives or standards enough to enhance the demand and productivity channel through which financial development contributes to growth. Low enforcement of the regulation may also lead to competitive imbalance between the regulated and non-regulated firms, hence making the regulatory environment unpredictable.

At the other end, very stringent regulation would increase labour costs much more than productivity, especially for the smaller firms or credit constrained firms. Despite increased access to finance, firms will tend to reduce hiring of labour, working hours and investments, or move activities into the informal sector. In this scenario, the growth contribution of financial deepening will be partially offset by regulatory costs.

The middle ground scenario will likely work out well in such a situation. Regulation that is moderate enough can improve worker incomes and labour standards without increasing cost sufficiently high to outweigh the gains from financial deepening. This kind of reasoning does not assume an absolute optimum numerical value but only implies that the conditional relationship among finance, employment and growth changes across different regulatory environment. Thus,

H1: Minimum-wage regulation creates statistically significant threshold regimes in the relationship between financial development, employment and economic growth, with the conditional growth effect varying across regimes.

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Data and Methodology

Sample and Data Sources

The study uses country-year panel data for 96 developing economies over 2000–2022. Countries are selected using the United Nations World Economic Situation and Prospects (WESP) classification, which considers development characteristics beyond a purely income-based classification. The final sample is constrained by the availability of complete information on financial development, employment, minimum-wage regulation and the control variables. The countries span Africa, Asia, Latin America and the Caribbean.

Most macroeconomic variables are obtained from the World Bank's World Development Indicators (WDI). The dependent variable is the natural logarithm of real GDP in constant 2015 US dollars (WDI indicator NY.GDP.MKTP.KD). It is an output-level measure, not the annual percentage growth rate; accordingly, coefficients are interpreted as associations with real economic performance rather than direct effects on a GDP growth rate. Financial development is measured using two proxies: domestic credit to the private sector as a percentage of GDP (DCPS) and broad money as a percentage of GDP (M3). Employment is represented by the total labour-force participation rate. Population growth, secondary-school enrolment, general government final consumption expenditure and gross fixed capital formation are used as controls for population dynamics, human capital, government expenditure and private investment, respectively.

The minimum-wage variable is obtained from the Fraser Institute's Economic Freedom data. In the thesis dataset the score ranges from 1 to 10, with lower scores corresponding to stronger minimum-wage regulation/higher minimum-wage conditions and higher scores corresponding to weaker regulation. The thesis interprets the resulting threshold regimes in terms of high, moderate and low enforcement. Because the Fraser score is not itself a direct count of inspections, penalties or compliance actions, the empirical results are more precisely interpreted as thresholds in minimum-wage regulatory intensity, with the enforcement terminology retained only to remain consistent with the original thesis classification.

Table 1: Variable Definitions And Data Sources.

Variable	Symbol	Measurement	Role	Source
Economic performance	Y	Natural logarithm of real GDP, constant 2015 US$ (NY.GDP.MKTP.KD)	Dependent	World Development Indicators
Domestic credit	DCPS	Domestic credit to private sector (% of GDP)	Financial development	World Development Indicators
Broad money	M3	Broad money (% of GDP)	Financial development	World Development Indicators
Employment	EMP	Labour-force participation rate, total	Moderator / interaction component	World Development Indicators

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Minimum-wage regulation	MW	Fraser Institute minimum-wage regulation score (1–10)	Threshold variable	Fraser Institute, Economic Freedom Index
Population growth	PG	Population growth (annual %)	Control	World Development Indicators
Human capital	HC	School enrolment, secondary (% gross)	Control	World Development Indicators
Government expenditure	GE	General government final consumption expenditure (% of GDP)	Control	World Development Indicators
Private investment	PI	Gross fixed capital formation (% of GDP)	Control	World Development Indicators

Dynamic Panel Specification

The empirical strategy first estimates a dynamic growth equation in which lagged GDP captures persistence and the finance-employment interaction tests whether financial development changes the conditional association between employment and economic performance. The lagged dependent variable and potentially endogenous finance, employment and interaction terms make pooled OLS and fixed-effects estimates vulnerable to dynamic-panel bias and simultaneity. System GMM is therefore used to instrument the potentially endogenous regressors with their own valid lags in the difference and level equations. The precise lag windows, variable classifications, time effects, and whether the instruments were collapsed or otherwise restricted must be reported from the original estimation command. A simplified representation is:

$$Y_{it} = \alpha Y_{it-1} + \beta_1 FD_{it} + \beta_2 EMP_{it} + \beta_3 (FD_{it} \times EMP_{it}) + \delta X_{it} + \mu_{it} + \varepsilon_{it}$$

where FD is alternately DCPS and M3, X is the vector of control variables, μ_i captures time-invariant country-specific effects, and ε_it is the idiosyncratic disturbance. The study estimates Difference GMM and System GMM in one-step and two-step forms, with System GMM treated as the preferred estimator because it combines equations in differences and levels and can improve instrument strength for persistent series (Arellano & Bond, 1991; Arellano & Bover, 1995; Blundell & Bond, 1998). Instrument validity is assessed using the Sargan test and serial correlation is evaluated using Arellano–Bond diagnostics. The two-step estimator is interpreted with the usual caution regarding finite-sample standard errors (Windmeijer, 2005).

Panel Threshold Specification

The central analysis uses Hansen's panel threshold approach to allow the effect of the finance–employment interaction to change when minimum-wage regulation crosses unknown cut-off values (Hansen, 1999, 2000). The threshold value is estimated rather than imposed a priori. For a two-threshold specification, the model can be represented as:

$$Y_{it} = \alpha X_{it} + \begin{cases} \beta_1 FD_{it} \text{ x EMPLY} + \varepsilon_{it};\ MW \le \gamma \\ \beta_2 FD_{it} \text{ X EMPLY} + \varepsilon_{it};\ \gamma < MW \le \gamma \\ \beta_2 FD_{it} \text{ X EMPLY} + \varepsilon_{it};\ MW > \gamma \end{cases}$$

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where is an indicator function and γ_1 and γ_2 are endogenously estimated threshold values. The analysis is conducted separately for DCPS×EMP and M3×EMP. This structure allows the conditional growth effect to differ across high-, moderate- and less restrictive regulatory regimes without assuming a linear relationship between minimum-wage regulation and growth. Threshold inference follows the least-squares procedure developed for unknown threshold models (Chan, 1993; Hansen, 1996, 2000). For each admissible value of the threshold variable, the model is estimated and the threshold estimate is selected as the value that minimises the concentrated sum of squared errors. The statistical significance of the threshold cannot be evaluated using standard critical values because the threshold parameter is not identified under the null hypothesis of no threshold. Accordingly, bootstrap likelihood-ratio inference is used. The bootstrap p-value is the proportion of simulated likelihood-ratio statistics that exceed the statistic obtained from the observed sample. The testing proceeds sequentially: a single-threshold model is tested against linearity; after a significant single threshold, a double-threshold model is tested; and a triple threshold is considered only after the double-threshold specification is supported. The baseline tests use 1,000 bootstrap replications, with additional sensitivity checks using 5,000 and 10,000 replications and alternative trimming percentages. Importantly, these bootstrap tests determine whether threshold nonlinearity exists and how many thresholds are supported; they do not test whether the regime-specific slope coefficients are equal to one another.

Robustness is assessed in two ways. First, the significance of the estimated threshold is re-evaluated across multiple bootstrap replications counts and trimming percentages. Second, the threshold models are re-estimated after excluding four countries identified as outliers—Panama, Oman, Samoa and Vanuatu leaving 92 countries. This design tests whether the intermediate-regime result is driven by extreme observations or a specific threshold-search configuration.

Empirical Results

Preliminary Evidence and the Finance Employment Interaction

The preferred two-step System GMM estimates establish the mechanism that motivates the threshold analysis. In the baseline interaction model, DCPS is positive and significant (reported coefficient 0.0588), and M3 is also positive and significant (0.0251). Employment alone is negative but statistically insignificant (−0.1717). In contrast, the interaction of DCPS with employment is positive and significant (0.1234), as is the interaction of M3 with employment (0.1223). The pattern is economically important: employment does not generate a robust growth effect in isolation, but its contribution becomes stronger when embedded in a more developed financial environment.

The preferred two-step System GMM specification contains 96 countries and 1,534 country-year observations for 2000-2022. It uses 81 instruments, producing an instrument-to-country ratio of 0.844 (81/96). Because the instrument count is below the number of countries, the preferred specification satisfies the commonly applied practical criterion for limiting instrument proliferation. The Sargan statistic is 29.7387 with a p-value of 0.3975; therefore, the null hypothesis that the overidentifying restrictions are valid is not rejected. The Arellano-Bond statistics are -1.5973 (p = 0.1102) for AR(1) and -0.2219 (p = 0.8244) for AR(2). The non-significant AR(2) result indicates no evidence of second-order serial correlation in the

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differenced residuals. These diagnostics support the preferred specification, although neither the instrument-count criterion nor a non-rejected Sargan test independently proves instrument validity. The precise lag windows, variable classifications, time effects and instrument-collapsing or restriction choices should be confirmed from the original estimation command.

Table 2: Two-Step System GMM Results

Variable	System GMM Two-Step
Constant	0.8493*** (0.0142)
Lag Y	0.9198*** (0.0012)
DCPS	0.0588*** (0.0013)
M3	0.0251*** (0.0148)
Employment	-0.1717 (0.0092)
DCPS × Employment	0.1234*** (0.0008)
M3 × Employment	0.1223*** (0.0057)
Population growth	0.0086*** (0.0003)
Human capital	0.0224*** (0.0022)
Government expenditure	-0.0124*** (0.0011)
Private investment	0.0119*** (0.0010)
Sargan test	29.7387 [0.3975]
AR(1)	-1.5973 [0.1102]
AR(2)	-0.2219 [0.8244]
Countries	96
Observations	1,534
Period	2000-2022
Number of instruments	81
Instrument-to-country ratio	0.844

Note: The table reports the preferred two-step System GMM specification. Coefficients are reported with standard errors in parentheses, while diagnostic p-values are reported in square brackets. ***, ** and * indicate statistical significance at the 1%, 5% and 10% levels, respectively. Y = real GDP; DCPS = domestic credit to the private sector; M3 = broad money; Employment = labour-force participation; DCPS x Employment and M3 x Employment are interaction terms. The instrument-to-country ratio equals 81 instruments divided by 96 countries.

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Threshold Selection for the DCPS Employment Channel

The first threshold model uses DCPS as the financial-development proxy. The single-threshold estimate is 5.133 (LR = 6.7258; bootstrap p = 0.0143), which is significant at the 5% level. Sequential testing supports a double-threshold specification with cut-offs of 3.617 and 5.133 (LR = 5.7621; bootstrap p = 0.0093). The LR statistic exceeds the reported 1% bootstrap critical value of 5.6133. The triple-threshold test is not significant (LR = 5.6612; bootstrap p = 0.1158). The preferred specification therefore divides the sample into three empirically identified regulatory regimes.

Figure 1
Confidence Interval Construction in Single Threshold Model

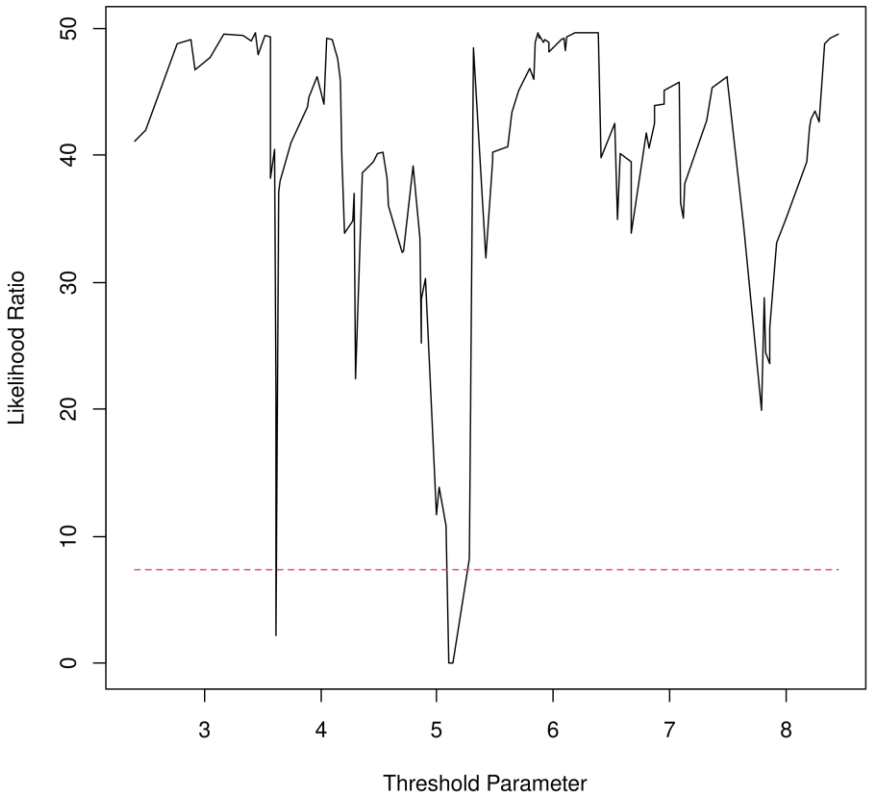


Figure 4.7: Plot of the Concentrated Likelihood Ratio for the Single-Threshold Model

The Fraser Institute score ranges from 1 to 10, and countries with more restrictive minimum-wage regulation receive lower ratings. Accordingly, MW ≤ 3.617 is labelled the more restrictive regulatory regime, 3.617 < MW ≤ 5.133 the intermediate regulatory regime, and MW > 5.133 the less restrictive regulatory regime. These labels concern the regulatory-index score and should not be treated as direct measurements of enforcement, inspections, compliance, or statutory wage levels.

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Table 3: Threshold Selection for The DCPS–Employment Model.

Model	Threshold value(s)	LR statistic	Bootstrap p-value	Critical values 10% / 5% / 1%
Single (5% significant)	5.133	6.7258	0.0143	4.9027 / 6.5542 / 7.8087
Double (1% significant; preferred)	3.617; 5.133	5.7621	0.0093	3.7596 / 4.3913 / 5.6133
Triple (not significant)	3.400; 3.617; 5.099	5.6612	0.1158	5.7214 / 6.0189 / 7.5017

Regime Specific DCPS Results

Table 4 reports the complete DCPS double-threshold regression output. As reported in the supplied table, DCPS (0.0006), the DCPS × Employment interaction (0.0176), population growth (0.0758), human capital (0.1274) and private investment (0.2192) carry positive significance markers, while government expenditure is negative (-0.0010) and employment is negative (-0.0766). The threshold coefficients are 0.0227 for MW ≤ 3.617, 0.0663 for 3.617 < MW ≤ 5.133, and 0.0382 for MW > 5.133. The supplied table marks the first coefficient at 10% and the second at 1%, while the third has no significance marker. However, several reported significance markers do not align arithmetically with the displayed standard errors and t-statistics, including the third-regime estimate. These values have to be validated against the software output obtained initially. Until such validation, the findings confirm the presence of threshold nonlinearity but not the ranking of the regimes on the basis of statistically distinct impacts. A positive coefficient of interaction between DCPS and Employment is in line with financial capability and employment working together, but it has to be viewed conditional in nature and with no implications for causality. Sequential bootstrap confirms double threshold model (LR = 5.7621; bootstrap p-value = 0.0093), indicating the existence of threshold nonlinearity. The estimate for the intermediate regime is greater numerically compared to those of other regimes, but the bootstrap test determines the presence of the threshold and the number of thresholds and not the equality of regime slopes. Thus, point estimates cannot be used to prove a statistically significant difference across the regimes.

Table 4: Double-Threshold Regression Estimates for the DCPS Employment Model

Variable or regime	Coefficient	Reported S.E.	Reported t-statistic
DCPS	0.0006***	0.0091	0.0659
Employment	-0.0766	0.0298	-2.6597
Population growth	0.0758***	0.0258	2.9379
Human capital	0.1274***	0.1134	1.1234
Government expenditure	-0.0010**	0.0005	-2.0000
Private investment	0.2192***	0.1029	2.1302
DCPS × Employment	0.0176***	0.0149	1.1812
More restrictive regulation: MW ≤ 3.617	0.0227*	0.0039	5.8205
Intermediate regulation: 3.617 < MW ≤ 5.133	0.0663***	0.0034	19.5000
Less restrictive regulation: MW > 5.133	0.0382	0.0032	11.9375

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Note: ***, ** and * denote the significance markers shown in the supplied results. The coefficient, standard-error, t-statistic and significance-marker columns should be verified against the original econometric output because several displayed values are not internally aligned.

Threshold Selection and Regimes for the M3 Employment Channel

The analysis is repeated using broad money as the financial-development proxy. Sequential testing again supports two thresholds. The single threshold at 5.133 is significant, and the double-threshold model produces cut-offs at 5.133 and 8.447 with an LR statistic of 5.3955 and a bootstrap p-value of 0.0089. The triple-threshold model is not significant. This replication across a conceptually different financial-development proxy is important because it shows that the non-linearity is not unique to private credit.

Figure 2
Confidence Interval Construction in Double Threshold Model

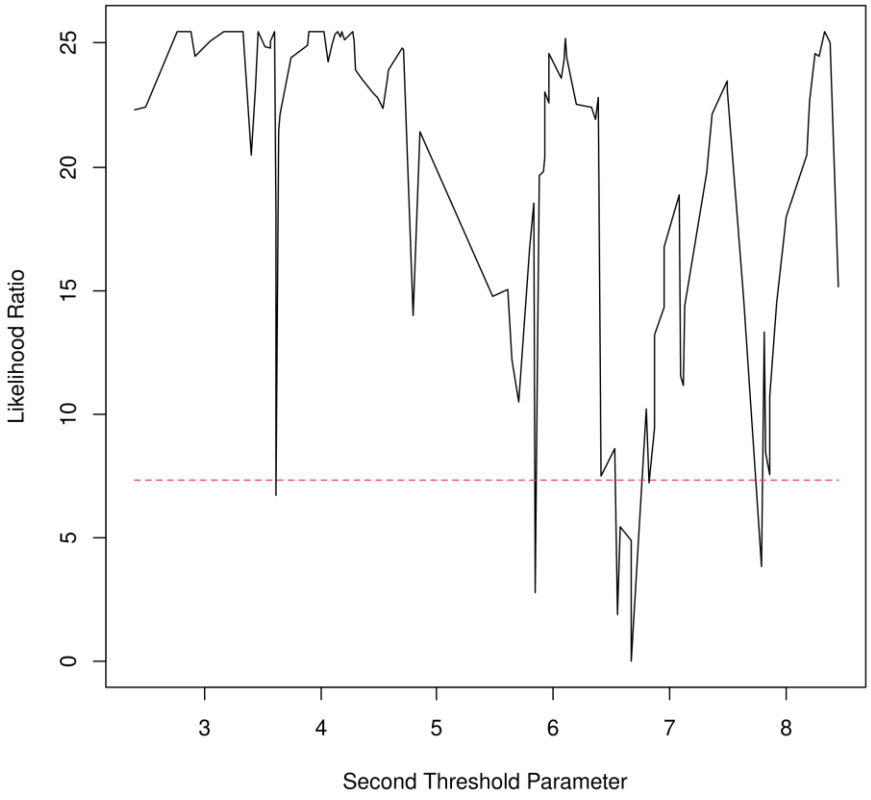


Figure 4.8: Plot of the Concentrated Likelihood Ratio for the Double-Threshold Model (Note: 95 per cent confidence intervals)

The reported regime coefficients in the baseline M3 threshold table are 0.0523 for MW≤5.133, 0.0762 for 5.133<MW≤8.447 and 0.0906 for MW>8.447. The first regime is significant at the 10% level, the middle regime is significant at the 1% level, and the third is statistically insignificant. Thus, although the point estimate in the third regime is numerically larger, it is not estimated with sufficient precision to support a reliable conditional growth effect. The middle regime again contains a statistically significant positive coefficient. Because the third-regime estimate is numerically larger but imprecise, significance in one regime and non-

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significance in another must not be interpreted as a statistically significant difference between coefficients.

Table 5: Threshold Selection for The M3–Employment Model.

Model	Threshold value(s)	LR statistic	Bootstrap p-value	Decision
Single	5.133	9.0027	0.0152	Significant
Double	5.133; 8.447	5.3955	0.0089	Significant; preferred
Triple	3.6437; 5.133; 8.447	5.3305	0.1214	Not significant

Table 6: Regime-Specific Threshold Estimates for The M3–Employment Channel.

Regime	MW interval	Reported conditional coefficient	Reported significance
More restrictive regulation	MW ≤ 5.133	0.0523	10%
Intermediate regulation	5.133 < MW ≤ 8.447	0.0762	1%
Less restrictive regulation	MW > 8.447	0.0906	Not significant

Robustness of the Threshold Results

The DCPS threshold finding is stable when the bootstrap design is varied. The thesis reports that the null of no threshold is rejected across 1,000, 5,000 and 10,000 bootstrap replications and across trimming percentages ranging from 5% to 30%. This reduces the likelihood that the result is an artefact of a particular resampling or trimming choice. The M3 threshold finding is similarly robust across alternative bootstrap settings.

The second robustness test examines sensitivity to influential observations. Panama, Oman, Samoa and Vanuatu are excluded, and the double-threshold model is re-estimated for 92 developing countries. The revised LR profile identifies threshold estimates of 5.0989 and 6.675; these estimates correspond to the values of the threshold variable at which the concentrated likelihood-ratio function reaches its minimum. The LR threshold statistic is 5.4885, and the bootstrap p-value is 0.0050 based on 1,000 replications, supporting the presence of threshold nonlinearity in the reduced sample. The conditional coefficient is 0.0290 for MW ≤ 5.0989, 0.0809 for 5.0989 < MW ≤ 6.675, and 0.0422 for MW > 6.675. However, the provided table provides significance indicators for the first two estimates but not for the third one. At the same time, the t-statistic value for the third estimate equals 11.7222 which contradicts the absence of a significance indicator. Such inconsistency is evident in some rows for the control variables. Thus, the original software output has to be verified prior to submission. In any case, the estimates excluding the outliers maintain the intermediate-regime pattern and prove that the results obtained in terms of the threshold hypothesis are not determined by the outliers exclusively. However, the omission of the outliers does not exclude the problem of simultaneity and causality; it depends on the strategy of identification.

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The change of cut-offs from 3.617 and 5.133 to 5.0989 and 6.675 demonstrates that the exact positions of thresholds are sensitive to the samples. Therefore, the cut-offs cannot be considered as universal policy targets. The robustness finding can be summarized as follows: the intermediate regime still maintains the largest point estimate even when the outliers are excluded. A cross-regime coefficient test has to be conducted in order to conclude about statistical superiority of the slope in the intermediate regime over the slopes in the other regimes.

Table 7: Outlier-Excluded Double-Threshold Regression Estimates

Variable or regime	Coefficient	Reported S.E.	Reported t-statistic
DCPS	0.0091***	0.0040	2.2750
Employment	-0.0264	0.0113	-2.3362
Population growth	0.0184***	0.0541	0.3401
Human capital	0.1054***	0.0985	1.0700
Government expenditure	-0.0009***	0.0001	-9.0000
Private investment	0.0980***	0.0345	2.8405
DCPS × Employment	0.0257***	0.0040	6.4250
More restrictive range: MW ≤ 5.0989	0.0290***	0.0035	8.2857
Intermediate range: 5.0989 < MW ≤ 6.675	0.0809***	0.0033	24.5151
Less restrictive range: MW > 6.675	0.0422	0.0036	11.7222
First threshold	5.0989		
Second threshold	6.675		
LR threshold statistic	5.4885		
Bootstrap p-value	0.0050		
Bootstrap replications	1,000		
Countries after exclusion	92		

Note: Panama, Oman, Samoa and Vanuatu should be left out. ***, ** and * indicate the levels of significance that appear in the provided table. It must be noted that many indicators are inconsistent with the standard errors and t-tests presented.

Discussion

The basic implication is that minimum-wage legislation affects the nature of the finance-employment-growth link. This particular finding is important for the following reasons: it refutes the simplistic assumptions that financial deepening has a constant impact on growth and that minimum-wage legislation can be assessed independently of the financial framework. In the case of developing countries, the impact of finance and employment on growth depends on the type of wage legislation in place.

The implication is in line with an enabling-finances view of employment. According to the GMM estimates, employment is not significant by itself, but it is positive and significant when interacted with DCPS and M3 variables. It means that employment becomes more conducive to growth when businesses and consumers operate in a financial sector that can generate credit

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and liquidity. Financing through credit can help pay salaries and fund payroll expenses, working capital and investments; monetary depth helps carry out transactions and mediate.

The regulation of the minimum wage alters the environment in which the complementarity effect works. Under the more stringent regulatory regime, the conditional effect is positive but smaller. An obvious explanation is that tighter wage regulation will improve labor earnings and working conditions but increase the cost of adjustment for firms with heterogeneous levels of productivity and financing. It is consistent with empirical evidence in developing countries where stringent and tight minimum wage regulations tend to lower the level of coverage of employment or induce substitution into informal activities (Neumark & Munguía Corella, 2021; Ham, 2018; Samutpradit, 2024). The channel does not necessarily mean that stringent standards are unproductive but the growth channel of financing to employment partially gets offset by regulatory cost.

The less restrictive regulatory regime is also not statistically favourable. In both baseline threshold models, the conditional coefficient is positive but statistically insignificant. Weak regulation may reduce compliance costs, but it can also limit the income, productivity and formalisation channels through which wage standards support aggregate demand and human development. Weak enforcement can create uneven competitive conditions between compliant and non-compliant firms and may reduce incentives to invest in worker retention, training or productivity. Badaoui and Walsh (2022) show why non-compliance can be widespread among low-productivity firms, while Kanbur and Ronconi (2018) emphasise that effective regulation cannot be inferred from legal stringency alone.

The middle regime may be interpreted cautiously as being consistent with compatibility between worker protection and firm adjustment capacity. In this regime, wage regulation is sufficiently meaningful to influence labour outcomes but not so stringent that the finance-enabled employment channel loses effectiveness. This interpretation is also consistent with more recent evidence that the effects of minimum-wage reforms depend on the capacity of institutions and firms to adjust. Nguyen (2025) shows that firms can respond through working hours rather than headcount, while González-Pampillón and Vázquez-Grenno (2026) document a dynamic compliance response in which enforcement strengthened after an initial deterioration. These results further strengthen the understanding that the impact of the minimum wage depends on institutions and adjusts along multiple margins of adjustment.

Furthermore, the juxtaposition of DCPS and M3 brings additional perspective into the analysis. The presence of an intermediate regime for the threshold effects with both credit development and monetary development indicators implies that the non-linearity does not depend on a particular financial development indicator. Nevertheless, the values of the thresholds are distinct, which means that the minimum wage policy cannot be considered independent of the structure of the financial system. The credit development indicator and monetary development indicator reflect different avenues: DCPS is more related to the private sector finances than M3.

Cross Regime Inference Limitation

However, the threshold output provides for the threshold nonlinearity using the sequential bootstrap. Future research should formally test the pairwise hypotheses H0: $\beta 1 = \beta 2$, H0: $\beta 2 =$

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β3, and H0: β1 = β3, together with the joint hypothesis H0: β1 = β2 = β3, for both the DCPS-employment and M3-employment threshold models.From the point of view of theory, the findings are consistent with endogenous growth, labour market and regulation theories. The development of the financial sector is a condition for capital formation and allocation; the presence of employment provides for the supply of labour; while the wage floor determines conditions at which labour is employed. The use of a threshold specification is appropriate in the present case since it makes it possible to modify the regulatory conditions of the impact of the finance-employment interaction in a way that its marginal effect is not constant.

Policy Implications

The key policy implication is calibration, not deregulation nor maximum stringency. The findings do not suggest that any form of minimum wage regulation that is weak will lead to growth by definition. Neither does it show that the most stringent form of regulation that is possible always leads to the maximum possible contribution of finance and employment to growth. The optimal regulatory approach is one where there is an intermediate form of regulation that leads to the most consistent significant effect on growth.

The first point is that there should be coherence between the wage setting policies and productivity as well as financing constraints of firms. This can be achieved through governments regularly assessing productivity and margin of different sectors, cost of living and size of firms in making any adjustment. Phased implementation with prior notification will help to minimize the uncertainty associated with the process as well as allow firms to make necessary adjustments regarding investment, pricing, technology and employment.

Second, minimum wage compliance must be credible, but risk based. Better inspection and compliance systems are necessary to ensure that there is not a race to the bottom in terms of labor standards, but compliance resources should be concentrated on those companies which habitually violate the law rather than imposing an additional burden on those businesses that comply. Compliance measures such as digital payroll reporting and electronic wage payments, inspections, and cross-agency information sharing between labor and tax agencies may help to achieve this end.

Third, policies for financial development need to explicitly favor labor intensive and productivity improving firms. Guarantees, relationship banking, working capital lines of credit and responsible digital finance may be used to help promising SMEs cope with changes in wages without cutting down on productive labor. The fact that DCPS×employment had a positive effect suggests that private credit is especially important for the growth through employment mechanism.

Fourth, any labor market policy should be supported by productivity policy. Minimum wage policies become more feasible for implementation if there are opportunities for firms to increase output per worker. Programs aimed at increasing the skills of workers, apprentice programs, improving managerial skills, using new technologies, logistics and technology access can all help to increase the ceiling on productivity above which wage increases become affordable. This is very relevant for developing countries, where the informal economy is big, as firms that cannot afford productivity enhancements might prefer informality.

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Furthermore, it is important for policy makers to observe several channels of adjustments. Just counting number of employees may fail to account for changes in hours worked, informality, non-compliance, compression of wages, business formation and exits or investments. Recent literature on Thailand, Vietnam and Uruguay demonstrates that the various channels may operate in opposite directions. Hence, the monitoring strategy should include formal and informal employment, hours worked, wage compliance, SMEs' performance and labor productivity.

Lastly, it is important to note that the thresholds derived in this study are not meant to serve as universal policy goals. They are simply cut-off points for a given regulatory index. Their usefulness is in showing that there is non-linearity; it is not in setting a specific number. Governments ought to employ their administrative and labor market statistics to determine the level at which regulations either fail to secure worker rights or are overly restrictive relative to productivity and business capability.

Conclusion Limitations and Future Research

The study explores an issue that lies at the nexus of development finance and labor market policies: Is there any effect of the regulatory framework of minimum wages on the relationship between financial development and employment growth? Panel data set is applied with a sample size of 96 developing countries from the year 2000 to 2022. In the estimation of dynamic GMM model, panel threshold regression model is employed. Two indicators of financial development domestic credit and broad money are separately considered.

The evidence points to three conclusions. First, financial development is positively related to growth, while employment alone is not statistically robust in the preferred dynamic specification. Second, the interactions between employment and both financial-development proxies are positive and significant, indicating that finance strengthens the employment–growth channel. Third, and most importantly, the relationship is non-linear with respect to minimum-wage regulation. Two statistically significant thresholds are identified in both the DCPS and M3 models. The middle regime produces the most consistently positive and statistically significant conditional effect, and this qualitative result survives alternative bootstrap settings and the exclusion of outlier countries.

The findings support a policy framework based on institutional complementarity. Financial development can help firms convert labour into productive output, but labour regulation influences the cost and incentives associated with that process. Very weak regulation does not generate a statistically reliable conditional growth effect in the threshold models, while the most stringent regime produces a smaller significant effect than the middle regime. The results therefore favour calibrated wage regulation supported by credible enforcement, access to finance, productivity enhancement and continuous monitoring.

There are certain limitations to be considered. The first one is related to measurement. Fraser Institute's minimum wage score that was used in the thesis is a regulatory index but not an administrative one, measuring, for instance, how often inspections take place or what kind of penalty is applied for violations of the laws. That means that the high/moderate/low enforcement classification is an interpretation of the regulatory score by the author of the thesis and cannot be treated as a measurement of enforcement capacity.

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Secondly, the sample contains diverse developing countries with differing institutional settings, level of formality, sectoral structure, demographic characteristics and financial structure. An interesting line of further research would involve an analysis of thresholds for different regions and income groups and see whether the intermediate regime pattern holds in different institutional environments. Thirdly, while the threshold regression reveals non-linear relationships, it does not in itself prove the existence of the quasi-experimental causal impact of wage legislation on unemployment. Fourthly, the existing data does not have any formal Wald tests of equality of the regime specific coefficients. As a result, it is not possible to prove formally that the intermediate regime coefficient is statistically greater than the other regime specific coefficients even if it happens to be numerically greater or significant.

Finally, there is the period of 2000 to 2022, which covers important global events such as the global financial crisis and the COVID-19 pandemic. Sensitivity analysis in the thesis involves excluding the pandemic years in the dynamic GMM approach, while future threshold studies can incorporate the concept of structural breaks. Finally, there are some discrepancies in terms of reporting of coefficients, standard errors and t-statistics in the tables provided in the thesis. Notwithstanding the limitations above, the main contribution of the paper is the identification of the importance of the regulation of the labour market for the development of the economy through finance and employment. Therefore, for developing countries, the key policy question is not only how to develop finance and improve wages but how to coordinate both processes.

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