Liberals and wages

By Paul Krugman
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Hillary Clinton gave her first big economic speech on Monday, and progressives were by and large gratified. For Mrs. Clinton's core message was that the federal government can and should use its influence to push for higher wages.

Conservatives, however — at least those who could stop chanting "Benghazi! Benghazi! Benghazi!" long enough to pay attention — seemed bemused. They believe that Ronald Reagan proved that government is the problem, not the solution. So wasn't Mrs. Clinton just reviving defunct "paleoliberalism"? And don't we know that government intervention in markets produces terrible side effects?

No, she wasn't, and no, we don't. In fact, Mrs. Clinton's speech reflected major changes, deeply grounded in evidence, in our understanding of what determines wages. And a key implication of that new understanding is that public policy can do a lot to help workers without bringing down the wrath of the invisible hand.

Many economists used to think of the labor market as being pretty much like the market for anything else, with the prices of different kinds of labor — that is, wage rates — fully determined by supply and demand. So if wages for many workers have stagnated or declined, it must be because demand for their services is falling.

In particular, the conventional wisdom attributed rising inequality to technological change, which was raising the demand for highly educated workers while devaluing blue-collar work. And there was nothing much policy could do to change the trend, other than aiding low-wage workers via subsidies like the earned-income tax credit.

You still see commentators who haven't kept up invoking this story as if it were obviously true. But the case for "skill-biased technological change" as the main driver of wage stagnation has largely fallen apart. Most notably, high levels of education have offered no guarantee of rising incomes — for example, wages of recent college graduates, adjusted for inflation, have been flat for 15 years.

Meanwhile, our understanding of wage determination has been transformed by an intellectual revolution — that's not too strong a word — brought on by a series of remarkable studies of what happens when governments change the minimum wage.

More than two decades ago the economists David Card and Alan Krueger realized that when an individual state raises its minimum wage rate, it in effect performs an experiment on the labor market. Better still, it's an experiment that offers a natural control group: neighboring states that don't raise their minimum wages. Mr. Card and Mr. Krueger applied their insight by looking at what happened to the fast-food sector — which is where the effects of the minimum wage should be most pronounced — after New Jersey hiked its minimum wage but Pennsylvania did not.

Until the Card-Krueger study, most economists, myself included, assumed that raising the minimum wage would have a clear negative effect on employment. But they found, if anything, a positive effect. Their result has since been confirmed using data from many episodes. There's just no evidence that raising the minimum wage costs jobs, at least when the starting point is as low as it is in modern America.

How can this be? There are several answers, but the most important is probably that the market for labor isn't like the market for, say, wheat, because workers are people. And because they're people, there are important benefits, even to the employer, from paying them more: better morale, lower turnover, increased productivity. These benefits largely offset the direct effect of higher labor costs, so that raising the minimum wage needn't cost jobs after all.

The direct takeaway from this intellectual revolution is, of course, that we should raise minimum wages. But there are broader implications, too: Once you take what we've learned from minimum-wage studies seriously, you realize that they're not relevant just to the lowest-paid workers.

For employers always face a trade-off between low-wage and higher-wage strategies — between, say, the traditional Walmart model of paying as little as possible and accepting high turnover and low morale, and the Costco model of higher pay and benefits leading to a more stable work force. And there's every reason to believe that public policy can, in a variety of ways — including making it easier for workers to organize — encourage more firms to choose the good-wage strategy.

So there was a lot more behind Hillary's speech than I suspect most commentators realized. And for those trying to play gotcha by pointing out that some of what she said differed from ideas that prevailed when her husband was president, well, many liberals have changed their views in response to new evidence. It's an interesting experience; conservatives should try it some time.