The wages of wage fear

By Bill Emmott
May 10, 2017 – *Project Syndicate*

If all else fails, try the previously unthinkable. It is not a bad principle for economic policy in the best of times. Today, it may be just what is needed: many Western countries – certainly the United States, Japan, and Germany, probably the United Kingdom, and soon much of the rest of the eurozone – should pursue direct government intervention in wage bargaining, especially for the lowest earners.

Japan has spent the last 15 years struggling with slow growth, anemic household demand (especially among poorer families), and rising inequality and poverty. Similar conditions now prevail in the US as well; indeed, they helped Donald Trump to be elected president, by creating a sufficiently large group of what he quite reasonably called "forgotten Americans." And before Trump's victory, such conditions spurred the UK's so-called "left behind" to vote for Brexit.

Without a sharp increase in wages – mainly statutory minimum wages – populism will continue to thrive, and most Western economies will remain saddled with slow growth. Inequality not just of income and wealth, but also of perceived political voice and influence, will continue to grow. And the temptation to pursue shortsighted solutions – such as closing borders and implementing protectionism – will become irresistible.

Yet the suggestion that governments should act directly to raise the price of lower-skilled labor is likely to be met with sharp intakes of breath and *sotto voce* comments that I must be mad. Don't I know that higher minimum wages risk causing unemployment? Haven't I heard of the "rise of the robots" and the growing power of automation, more generally, to destroy jobs? Don't I believe in market solutions?

The answer to all three questions is "yes." But policies need to be tailored to conditions, and they need to reflect choices between the competing interests of different groups. (Indeed, that is the whole point of politics.) And current conditions, together with the interests of the "left behind," indicate that the once-unthinkable has become essential, if not inevitable.

The main reason why governments are leery of intervening in wage setting is the memory of the failed wage and price controls during the period of high inflation in the 1970s – controls that gave rise to large and troublesome distortions. But a second, more current reason relates to lobbying from businesses, which argue that corporate competitiveness depends on cheap labor. Governments also have their own self-interest to consider: the public sector often employs a lot of minimum-wage earners.

But it is time to take courage. Fiscal policy – cutting taxes or raising public spending – is too constrained by high government debt to be much use in stimulating demand, and attempts to use it to redistribute resources from rich to poor have created their own problems. Monetary policy – in particular, the vast money-printing "quantitative easing" programs pursued by central banks in recent years – has run out of space, too, with price inflation ticking up and central-bank balance sheets a record size. Wage intervention is virtually the only option left.

Moreover, the risks of raising the minimum wage are probably not as great as they have been made out to be – at least not now. To be sure, there are times when such wage increases can risk killing employment. But today is not one of those times: countries like the US, Japan, Germany, and the UK are at virtually full employment.

The risk in these countries is not the risk of rising unemployment, but stagnating wages, which has caused household demand to remain depressed or grow only sluggishly, thereby deterring businesses from investing. In the US, low wages at the bottom end of the labor market have discouraged millions of working-age individuals from even seeking employment. That certainly can help to reduce the official unemployment rate, but it does little for the economy.

The US federal minimum wage of $7.25 per hour is one-third lower in real (inflation-adjusted) terms than it was at its peak in 1968. Japan's average statutory minimum wage of ¥823 ($7.40) per hour is barely higher. Even where the authorities have taken steps to raise minimum wages – the UK since last year, as well as US states like California and New York, which are targeting a $15 hourly minimum wage by 2020 – they are not moving fast or far enough. Japan is raising its minimum wage only slightly faster than inflation.

Inequality remains the scourge of our era, with the bargaining power of the lowest-skilled workers severely undermined by automation and developing-country competition. If "forgotten" groups are not to be permanently left behind and alienated, governments must take bolder action.

In the 1960s, Japan's "income doubling" plan helped it to develop a consumer economy. Perhaps the time has come to introduce a "minimum-wage doubling" plan, implemented over a few years, thus giving business the chance to adjust. For leaders who have received the financial support of the very rich and the electoral support of those left behind, such a plan would seem to be a political winner. Any interest, President Trump?

Bill Emmott is a former editor-in-chief of The Economist.