

# Ontario gets it right with move to higher minimum wage

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The Ontario government's decision to raise the provincial minimum wage to \$15 an hour by 2019 has set off a storm of predictable criticisms. Higher wages will, it is said, result in job losses, raise consumer prices and will do little to help low-wage workers. One constituency that has mostly declined to join this chorus of boos has been professional economists. What is the view of research economists on the consequences of this interference with the market mechanism?

A generation ago, most economists believed that minimum wages constituted a classic parable of self-defeating interventionism – a well-meaning attempt to dictate higher wages only reduced employment, thus hurting the very workers they were supposed to help.

This view was based on the belief the labour market behaves like a classic competitive market, in which the forces of demand and supply determine wages, over which employers have no control. Earlier empirical work reinforced these beliefs. It was also believed that higher minimum wages would do little to reduce inequality and improve the lot of low-wage workers – in part because the benefits to those who kept their jobs would be offset by costs imposed on job losers, and also because many minimum-wage workers were assumed to be teenagers in well-to-do families.

But most research economists abandoned this simple-minded picture some time ago. For over 20 years now, many highly credible studies have found that the disemployment effects of higher minimum wages are generally very close to zero. The pioneering empirical work by Princeton economists David Card (a Canadian) and Alan Krueger in the 1990s investigated empirical data on the impacts of real-world minimum-wage increases by carefully studying the natural experiments created when one

jurisdiction increased its minimum wage, but others – often right across a state boundary – did not.

Their results shocked the economics profession. They found almost no impact of higher minimum wages on employment – and in some cases higher minimum wages were associated with more employment. Their now-classic book, *Myth and Measurement*, published in 1995, initially sparked enormous controversy. But the essence of scientific advance is the replication of empirical results. Since then, many highly credible empirical studies have confirmed the basic findings: there is almost no employment impact from moderate increases in minimum wages. Substantial recent research in Canada, the United States and Britain also concludes that higher minimum wages succeed in lifting incomes for low-paid workers and reducing wage inequality.

The prevailing view of how labour markets function has also changed dramatically. Building on pioneering work by Peter Diamond, Dale Mortensen and Chris Pissarides – for which they received the Nobel Prize in 2010 – most economists now employ models with imperfect information and search frictions, rather than the simple competitive model (with its strong assumptions, like perfect information). In such an environment, employers have some market power in wage setting.

“High-wage” and “low-wage” firms can co-exist in the same sector, since high-wage employers benefit from lower recruitment costs, reduced turnover and perhaps more motivated employees. In this environment, economic theory implies that moderately higher minimum wages can increase or decrease employment.

In today's new consensus, Nobel Prize winner Paul Krugman cites Mr. Card and Mr. Krueger with starting an "intellectual revolution" in economics. Seven other Nobel Prize winners endorse a 40-per-cent increase in the U.S. minimum wage and a former editor of *The Economist*, the world's most influential free-market voice, recently called for big minimum-wage hikes to help boost lacklustre purchasing power across the industrialized world.

Ontario's move is ambitious but hardly unprecedented. Alberta's minimum is heading to the same level, and the City of Vancouver will pay more than \$20 an hour to its workers and outside suppliers. Other cities have adopted similar "living wage" policies. South of the border, three U.S. states are moving to \$15 (U.S.), and dozens of cities have already done so. There is no credible evidence that this clear trend in labour policy is hurting job creation.

But careful studies find that recent minimum wage increases are boosting spending power for low-income workers and reducing inequality.

Far from joining those who warn of economic disaster from the higher minimum wage, we were glad to add our names to the list of over 50 economists endorsing the measure in a recent public letter. In our judgment, the economic arguments for higher minimum wages are both credible and compelling.

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