Economists argue about minimum wages

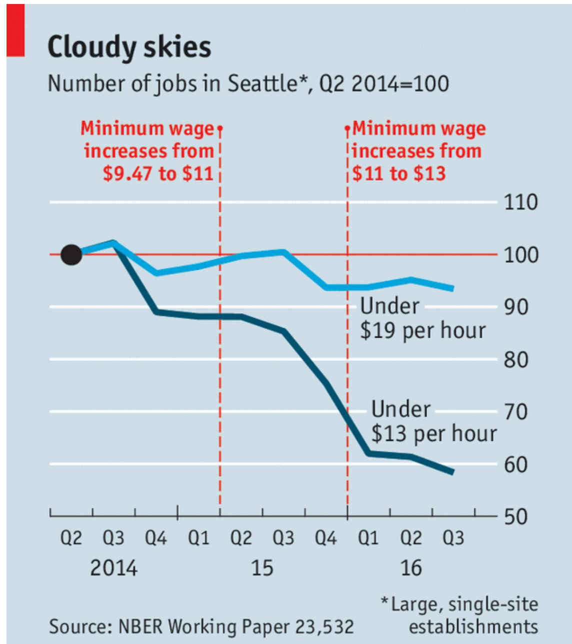
July 8, 2017 – *The Economist*

Just what is the point of a minimum wage? It seems a straightforward enough question to answer. Minimum wages are designed to protect vulnerable workers who might otherwise lack the bargaining power to command a decent pay package. They are a means to limit severe poverty among those in work.

Yet they also attract opposition from critics who see wage minimums as price controls that discourage firms from hiring as many workers as they otherwise might. For decades, feuding camps of dismal scientists have tussled over whether the good done by minimum wages outweighs the bad. A series of recent minimum-wage increases in America will shine a light on that question and others as well. Indeed, the time may have come for economists to broaden their view of just what a minimum wage is meant to accomplish.

As voter frustration at stagnant pay has grown, politicians on the American left have spotted an opportunity to court popularity by calling for higher minimum wages. Democrats are united behind a demand for a national minimum wage of $15 an hour, more than double the current $7.25 rate. State legislatures in California and New York have enacted laws that gradually raise their minimum wages to $15. Few governments, however, have moved as aggressively as the city of Seattle. In 2014 the council voted to raise the minimum wage, the hourly rate set by the state of Washington, then $9.32, to $11 an hour from April 2015, followed by further rises, to $13 in January 2016 and $15 in January this year. Smaller firms and those that provide benefits on top of pay were given longer to implement the changes.

On the surface, Seattle's economy seems to have weathered the increases well—indeed,



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to have benefited from them. Since the initial rise, in April 2015, the unemployment rate in the surrounding area has fallen from 4.3% to 3.3% and employment has grown strongly. An analysis published in June by the Centre on Wage and Employment Dynamics at the University of California, Berkeley, compared employment in the food-services industry in Seattle with that in the same industry in comparable areas elsewhere over the period of the first two increases (to $11 and then $13). It concluded that, despite increased wages in the industry in Seattle, there was no detectable effect on employment.

Another recent analysis, however, by a team from the University of Washington, arrives at a very different conclusion. Its authors use data that are not publicly available, on wages earned and hours worked by individuals. They also find that the increase in the minimum wage to $11 seems not to have had much of an effect on employment. But the second rise, to $13, led to a sharp decline in both jobs and hours worked below $13 an hour (as the new rate was phased in), which was not fully matched by increases in jobs and hours worked at or above $13. The hours lost were large enough to result in a net reduction in pay to low-wage workers averaging $125 a month in 2016.

The paper attracted withering criticism from some other economists. Some noted that its analysis left out workers who adjusted to the changes by becoming contractors rather than full employees or by moving away from Seattle, or who switched to jobs at large firms with multiple locations (which were not included in the data set used by the authors). Others pointed out that even though there was no offsetting rise in employment at wages between $13 an hour and $19 an hour, employment at wages above the $19 mark rose sharply. What is more, the fine-grained data used in the report covered only the state of Washington, whereas other parts of America might have provided a better control case. Some of these criticisms are stronger than others. There are limitations to the data, as the authors themselves admit, and this is hardly the last word on the subject.

Elastic bands

But these studies raise other pressing questions. Another way of looking at the effect of higher wages on employment is by calculating what economists call the "elasticity of employment" with respect to wages: that is, by how much employment changes for a given change in the wage. Most studies find an elasticity of around zero, meaning that whatever employment changes occur in response to a minimum-wage change, positive or negative, they are relatively small. The University of Washington team, in contrast, finds that in moving from $11 per hour to $13 the elasticity was close to -3: that is, small jumps in the wage led to freakishly large declines in employment. Subsequent studies should provide clues about how robust that finding is. If true, however, it suggests that firms can more easily adjust their business models to reduce the role of low-wage labour than was previously believed: by automating, perhaps, or by eliminating jobs that were not particularly necessary in the first place.

For politicians looking to improve the fortunes of low-paid workers, signs that higher minimum wages lead to job losses will suggest that other tools, such as wage subsidies, must be relied on more heavily. But another question might also be asked. If workers can find employment only at a low wage, is society actually better for having those jobs? Tens of millions of workers fall into such categories. Nearly 13m American workers, for example, are employed in food preparation. The Bureau of Labour Statistics reports their median hourly wage is just $10 an hour.

If, at higher minimum wages, some of these low-wage workers end up being unemployed, that is personally and socially destructive. But if research suggests that large numbers of workers can find jobs only if wages are low enough to discourage firms from automation, or to encourage them to create unnecessary jobs, then the right balance between a minimum wage and other income-boosting measures might not be the big concern. Instead, politicians need to think harder about how to prepare workers for higher-paid, higher-productivity jobs—or, failing that, how to help them contribute in roles outside paid private-sector work.