The Economist

Minimum wages

A reckless wager

A global movement toward much higher minimum wages is dangerous

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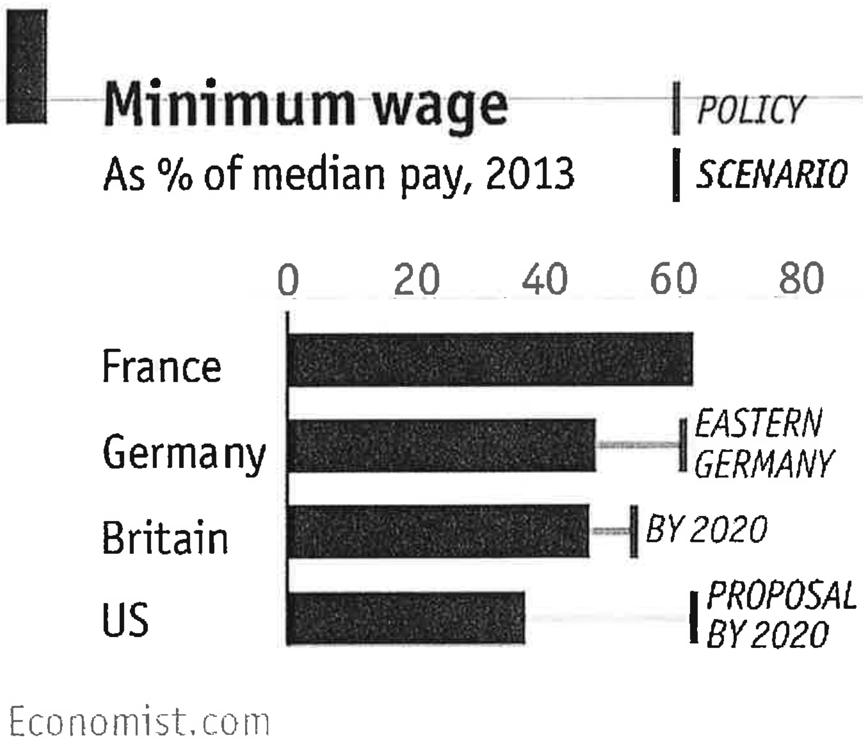

WHEN prices rise, demand falls. Exceptions to the most basic rule of markets are curiosities—the kind of thing an economist might bore you with at a dinner party. Set carefully, minimum wages can provide such an example. But policymakers must not assume this is a cast-iron law. Big rises in minimum wages are a gamble with people's futures.

Modest minimum wages do not seem to sap demand for labour. Truckloads of studies, from both America and Europe, show that at low levels—below 50% of median full-time income, with a lower rate for young people—minimum wages do not destroy many jobs. When Britain set a new minimum wage in 1998 doom-mongers forecast that jobs would vanish. Employment proved resilient. Minimum wages help offset firms' bargaining power over employees reluctant to risk moving elsewhere. They may even boost productivity and reduce staff turnover by making workers value their jobs.

Encouraged by this evidence, many are clamouring to make minimum wages far more generous. In America campaigners want the federal minimum wage more than doubled from today's stingy $7.25 an hour to $15 an hour, or 77% of median hourly income. They have had some success; several big cities, including New York this week, plan to phase in a $15 minimum wage, and Hillary Clinton's two rivals for the Democratic nomination support the policy (see article (http://www.economist.com/news/united-states/21659732-presidential-candidates-ideas-boosting-wages-reveal-different-diagnoses-how)). In Britain the Conservative government is overruling the technocrats who usually set the wage floor to shift it from 47% to 54% of median pay. Germany has introduced a minimum wage which is reasonable in, say, Cologne but is worth a generous 62% of median pay in the poorer east of the country.

By moving towards sharply higher minimum wages, policymakers are accelerating into a fog. Little is known about the long-run effects of modest minimum wages (see page 66). And nobody knows what big rises will do, at any time horizon. It is reckless to assume that because low minimum wages have seemed harmless, much larger ones must be, too.

One danger is that a high minimum wage will push some workers out of the labour force for good. A building worker who loses his job in a recession can expect to find a new one when the economy picks up. A cashier with few skills who, following the introduction of a high minimum wage, becomes permanently more expensive than a self-service checkout machine will have no such luck. The British government's defence of its new policy—that a strong economy will generate enough jobs to replace those lost to a higher minimum wage—is disingenuous: the jobs are still lost. That is why Milton Friedman described minimum wages as a form of discrimination against the low-skilled.

This is the worst time to be raising the cost of workers. Technological advances are enabling firms to replace more and more people with computers and robots, imperilling jobs. Some low-skilled positions, such as cleaning, are hard to automate. But millions of low-skilled workers sitting at checkouts and receptions, picking products off warehouse shelves and even driving lorries are vulnerable to replacement. An ever-higher minimum wage will encourage investment in the technology to replace them. Higher minimum wages will also affect workers in tradable sectors such as tourism and manufacturing, where they risk losing ground to foreign competitors.

The irony is that minimum wages are a bad way to combat poverty. The Congressional Budget Office reckons that only one-fifth of the income benefits go to those beneath the poverty line. The richest 10% of British households will benefit more from the higher rate than the poorest 10%, because many low-paid people are their family's second earners.

What is more, a minimum wage is not free. Someone must pay. The common refrain that companies will shoulder the burden is the product of hope rather than evidence. If the cost is passed on to consumers, the minimum wage turns into a subsidy funded by a sales tax—a revenue-raiser that, again, falls heavily on the poor.

Minimum thought

Better tools are available. Tax credits (income top-ups for low earners) are a much more efficient way for governments to help the poor—about three-quarters of the benefit ends up with employees. To the extent that firms benefit, they are encouraged to employ low-skilled workers rather than automate jobs. Minimum wages have a powerful emotional and political appeal. But governments should deal in evidence not sentiment. Minimum wages can work as part of the policy mix only if they are modest. Set too high, they harm the very people they are supposed to help.

From the print edition: Leaders

Monetary Effect of Federal/Oregon Minimum Wage Differential

Year	Federal Minimum Wage	OR Minimum Wage	Regular Hours Worked	Overtime Hours Worked	Compensation Expense Difference	Additional Labor Burden (Payroll & Umployment taxes, workers comp, etc.)	Additional 401K Contribution*	Total Monetary Effect of Fed/OR Minimum Wage Differential
2015	7.25	$ 9.25	1,000,000	50,000	2,150,000	279,500	17,200	2,446,700
	7.25	$ 13.50	1,000,000	50,000	6,718,750	873,438	53,750	7,645,938
	7.25	$ 15.00	1,000,000	50,000	8,331,250	1,083,063	66,650	9,480,963

* Assuming 20% participation

Competitor States

Blueberries		
Maine	$	7.50
Wisconsin	$	7.25
Georgia	$	7.25
Pumpkin		
Illinois	$	8.25
N Carolina	$	7.25
S Carolina	$	7.25
Corn		
Midwestern States	$	7.25