

CONTRA: THE STATUTORY MINIMUM WAGE: DANGERS INHERENT IN SUCCESS

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There has been a welcome sea-change in economic thinking on the minimum wage in the past five years: a shift towards a conditional and qualified defence of such measures which was long overdue. *The danger now is that this triumph could backfire, against the desires of those who achieved this for economics as an empirically-based discipline.*

How might this happen?

- Modest empirical claims made in defence of the minimum wage may easily, in the political process, be converted into unintended exaggerations, and thence into campaigns for undesirable extension of regulatory measures.
- Further policy research on minimum wages may be neglected.
- Focusing attention on minimum wages can crowd out more difficult, expensive, long-term fundamentals, rather than bringing them into the policy eye.

There are strong reasons for the public, and politicians, to latch on to this “unfunded mandate,” as a *substitute* for the spending required by training and education, the more important part of any serious package. The latter measures are more complex, promising long-term gains. Everything in the political arena militates in the direction of myopia. The danger is that we will end up once again with series of short-term measures; the far more costly and

rewarding programmes which can raise productivity will always be just over the time horizon.

With enthusiasm for this virtually free lunch, there is a tendency for modest claims on minimum wages to be distorted by public debate. None of the new findings on minimum wages are intended to go beyond this: “they are not terribly harmful and in fact even have slightly beneficial effects both on low-wage workers and on the overall distribution of income” (Edward M. Gramlich, *Brookings Papers on Economic Activity*, 1976).

This conclusion for the US minimum wage was accepted two decades later as an idea whose time had come, with the remarkable reception of David Card and Alan Krueger’s *Myth and Measurement: The New Economics of the Minimum Wage* (1995). These authors were equally circumspect. Yet popular sentiment quickly ignores what Krueger noted soberly (*LoWER Newsletter*, number 6, March 1999, page 2):

“I think to a first order of approximation the minimum wage has essentially no effect on unemployment ... Now this does not mean that this can go on forever. Even in a dynamic monopsony model at a certain point one would hit the demand curve. So I think that this is a reason for being somewhat cautious about the impact of another minimum wage increase in the U.S.”.

For the European cases (with more reason for caution, given the higher minima as a proportion of the average wage), powerful additional evidence was provided by Dolado et al. (*Economic Policy*, 1996), with the pithy summary observation: “The (good and bad) effects of minimum wages have been exaggerated.”

All these conclusions are closer to faint praise than to ardent advocacy. The evidence says nothing about large increases in the minimum wage, or about long-term results. The difficulties of analysing long-term effects are as daunting as Richard Freeman claimed when he offered to “bet



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the family house” that no such analysis could be robust.

The breakthrough of the “revisionists” should not be sought in policy recipes, but as a corrective to decades of dominance by an extraordinarily primitive story of labour markets. (The lack of subtlety was so evident that George Stigler, the best-known opponent of the minimum wage, suggested in the 1970s that economists’ views on this were threatening to bring the entire profession into disrepute.)

I avoid the temptation to use more space to attack this ossified orthodox view and its conceit that the “laws of supply and demand” – in fact, a particular static partial equilibrium model – has achieved the same predictive success as Newtonian physics. This tale of fundamentalism gone awry does not change a key reality: the economist’s appreciation of the limits set by market forces is much more respectful than the average citizen’s. This concern is not merely speculative. In the growing U.S. municipal

movement for “living wage” ordinances, it is possible to see exactly these dangers.

Consider the policy hazard that research will suffer now the exciting “revisionism” has been done. We would not draw the implications of substantial non-compliance on minimum wages in most countries, about choice among alternative minimum wage regimes, or about deeper implications of the research for the understanding of how labour markets actually work. This last item is significant in the evaluation of other key policies, particularly credits for low-paid workers with families.

The rather unpalatable reality is that the key measures needed are much more expensive, complex, untested, and demanding of institutional innovation than minimum wage legislation. The latter may be a decent weapon, but it is a very limited weapon, with a possible boomerang effect. It is time to figure out how to build the necessary consensus for much more far-reaching efforts to improve the situation of the low paid.