Why We Need A Minimum Wage

By: Frances Coppola, Forbes Magazine.com

There is constant grumbling from free market aficionados that a minimum wage destroys jobs, particularly for the young. Obama’s [proposal](http://www.theguardian.com/world/2013/dec/04/obama-support-minimum-wage-inequality-speech) to raise the minimum wage is running into opposition in Congress despite [evidence](http://www.cepr.net/documents/publications/min-wage-2013-02.pdf) that it would have little effect on job supply. In the UK, the Chancellor of the Exchequer has [recently ruled out](http://www.theguardian.com/society/2014/jan/09/minimum-wage-increase-above-inflation-george-osborne-cautions-jobs) any real increase in the minimum wage. And in Germany, [debate continues](http://www.ibtimes.co.uk/german-employment-hits-record-high-2013-angela-merkel-eyes-minimum-wage-1430805) over whether to introduce a minimum wage at all.

Arguments in favour of a minimum wage mostly hang on the idea that firms have a responsibility to ensure that their workers earn enough to live on. If a firm can’t pay its workers enough to live on, then it isn’t a viable business, because it is dependent on wage subsidies. Of course “enough to live on” depends where you live: the cost of living in London is considerably higher than it is in, say, Newcastle, so a minimum wage that would give a reasonable standard of living in Newcastle is starvation level in London. The campaign for a [voluntary Living Wage](http://www.citizensuk.org/campaigns/livingwage/the-living-wage-foundation/)tries to persuade firms to pay above the current UK minimum wage, which is perceived as being below the real cost of living.

But whether a minimum wage reduces jobs or improves welfare is entirely beside the point.  I find it astonishing that many of the same people who oppose minimum wage legislation are in favour of in-work benefits and measures to force the unemployed to work. They haven’t thought it through.

The real reason why we need a minimum wage has nothing to do with the welfare of workers or the availability of jobs. Welfare is adequately ensured by in-work benefits, and the State is perfectly happy to create the illusion of employment in order to please voters. No, the minimum wage is necessary to protect taxpayers from the rational desire of firms to get something for nothing.

The simple fiscal argument for minimum wage legislation goes like this. Both the UK and the US have systems of in-work benefits that top up wages to a level sufficient to live on. So from firms’ perspective, when there is slack in the labour market (unemployment) they have little incentive to pay wages high enough to live on. And from workers’ perspective, they have little incentive to demand higher wages, especially if the consequence might be unemployment. If there is no minimum wage, therefore, then the co-existence of unemployment with in-work benefits drives down wages to below subsistence level.  As the majority of government tax income comes from households, not firms, over time this becomes unsustainable: all unskilled workers become in effect employees of the state, and the higher skilled are forced to subsidise the wages of the unskilled through rising taxes. There would inevitably be calls for in-work benefits to be cut, probably supported by demonization of the poor. Unskilled workers would be subject to the same accusations of “fecklessness” and “scrounging” as the unemployed already receive.  So in-work benefits without a legislated minimum wage are fiscally unsustainable and socially divisive when there is persistent unemployment.

This simple analysis does of course assume that unemployment is a real threat to a worker’s standard of living.  But [arguments that](http://www.saylor.org/site/wp-content/uploads/2011/05/ECON305-3.3.3-Labor-LeisureHandout2.pdf) the unemployed “choose leisure” imply that unemployment is a choice. If it is, then it cannot really be seen as a realistic threat. If the unemployed can refuse work without cost or sanction, then unemployment benefits themselves act as a minimum wage and there is no need for additional legislation.

Unemployment benefits may actually act as a MAXIMUM wage when there is persistent unemployment, since a worker demanding higher wages can always be replaced at close to unemployment-benefit levels. We know that a legislated minimum wage acts as a wage ceiling as well as a wage floor: it seems reasonable to suppose that an implied minimum wage due to unemployment benefits would do so too. The effect of unemployment benefits is therefore to drive down unskilled remuneration to nearly the same level as unemployment benefits. Where in-work benefits exist and there is no legislated minimum wage, nominal wages may actually be far lower than unemployment benefits, since employers are likely to set wages in the expectation that most workers will qualify for benefits – indeed they may deliberately choose to employ workers who qualify for benefits, because they can pay them less. Those who think employers wouldn’t do this should look at the “[roundsman](http://en.wikipedia.org/wiki/Roundsman_System)” system that operated in England in the [eighteenth and early nineteenth centuries](http://www.pieria.co.uk/articles/an_experiment_with_basic_income): farmers deliberately used roundsmen (unemployed labourers auctioned off at below market rates) in preference to free labourers because they could pay them less in the certain knowledge that parishes would top up the wages.

The effect of such an implied ceiling on remuneration is that workers become indifferent between working and unemployment: indeed when unemployment is high, jobs are scarce and finding them costly, those without jobs may choose to remain unemployed until the jobs market improves. So at the margin, unemployment can indeed be a choice.

But the low-paid don’t like the unemployed getting nearly as much remuneration as they do. It seems unfair and it creates political unrest. Governments of all colours therefore respond to indifference between work and unemployment by cutting out-of-work benefits to “make work pay”. This creates a “race to the bottom”, which in the absence of in-work benefits results in increasing poverty for both unemployed **and employed**. This was the situation in Victorian England, where conditions in the[workhouses](http://en.wikipedia.org/wiki/Workhouse) became appalling because conditions for unskilled workers were also appalling. There was, if you like, a competitive market in poverty.  But it would have been even worse without the workhouses. Grim though they were, workhouses did set an implied minimum wage in much the same way as unemployment benefits do. Without them, nominal wages would have fallen even further. After all, when there is high unemployment, firms don’t care if workers and their families starve. There are plenty more where they came from.

In-work benefits set a floor on the level to which effective incomes can fall, which prevents a “poverty market” from developing.  But in the absence of a legislated minimum wage, in-work benefits encourage employers to reduce nominal wages to well below subsistence level.  And this increases the proportion of workers’ remuneration that is borne by the State. If the State increases in-work benefits to try to preserve some sort of differential, employers will simply cut nominal wages even more.  Wage subsidies drive down wages. It is entirely reasonable for the State to set a floor on the contribution it will make to workers’ remuneration.  When there are in-work benefits, a legislated minimum wage is a subsidy floor.

An alternative to “making work pay” by cutting out-of-work benefits is forcing the unemployed to work by imposing sanctions such as loss of benefits for refusing jobs, or limiting the length of time for which benefits will be paid. But benefit sanctions and time limits amount to cutting unemployment benefits, and have exactly the same effect: they drive down wages. Sadly, this approach is increasingly being adopted by Western governments, usually coupled with some kind of “[workfare](http://en.wikipedia.org/wiki/Workfare)”. Workfare is even worse than simple sanctions, since it displaces other workers. It does not reduce unemployment, but it does reduce wages. When there are in-work benefits but no legislated minimum wage, sanctions and workfare both result in the State bearing more of the cost of unskilled employment.

But governments remain hell-bent on forcing the unemployed into work, any work, however poorly paid and however unsuitable, even if this crowds out other workers. The cost of trying to compel people to work is considerable. When there is persistent unemployment, destroying people’s ability to choose whether or not to work forces down wages. So as long as the unemployed do not have a real choice not to work, wages will continue to fall and the benefits bill will continue to rise.

Personally I would rather people had a real choice between work and leisure.  I would like to see the end of sanctions for refusing jobs, the elimination of workfare schemes, and the provision of a [basic income](http://www.pieria.co.uk/articles/moral_aspects_of_basic_income) replacing both in-work and out-of-work benefits. But while such a liberal solution remains politically unacceptable, a minimum wage set at subsistence level will be essential for fiscal sustainability.

To Protect The Defenseless, We Must Abolish The Minimum Wage

By Don Watkins, Forbes Magazine

A few years ago, I was in need of some extra cash so I decided to sell my laptop on eBay. A few days later, I got an offer. It wasn’t great, but then neither was my laptop. But before the payment went through, I got a call from the government.

“We have decided that the offer you got was too low. We’re not going to let you sell your laptop for anything less than three hundred dollars.”

“But no one is willing to pay me three hundred dollars,” I said. “I’d rather have two hundred bucks than nothing.”

“Oh, no, you can’t do that,” I was told. “That would be unfair to you.”

Far fetched? Maybe—it didn’t actually happen to me. But the fact is it happens to defenseless victims every single day, albeit in a somewhat different form: through enforcement of the minimum wage.

Right now there is a campaign underway to raise the federal minimum wage from $7.25 to $9 or more, and polls indicate that Americans overwhelmingly support it. And who wouldn’t? Who could object to making sure that everyone can earn a living? Who would oppose guaranteeing that every American is paid fairly?

Well, the problem is that the minimum wage doesn’t ensure everyone can earn a living—it ensures that many of us can’t earn anything. And it doesn’t guarantee that everyone is paid “fairly”—it unfairly denies us the freedom to decide for ourselves what pay to offer or accept.

I remember when I got my first job. I had just turned seventeen and after a bit of a search—I think I submitted three applications at the local mall—I got a call to interview for an entry-level position as a ticket taker at the mall theater. I sat down with Michelle, the theater’s hiring manager, and after going over my work experience—“I once helped my dad wash his car”—Michelle offered me a starting position at $5.35, just above the minimum wage at that time. I remember thinking: it’s not much, but it’s better than anyone else is offering me, and it’s certainly better than being out of work.

And that’s how employment should work. Employment is a contract—an arrangement between a person who wants to work and someone who wants to hire him. But under minimum wage laws, Michelle and I weren’t the only ones who had a seat at that negotiating table.

Had Michelle only offered me $5 an hour and had I wanted to accept it, Mr. Minimum Wage Enforcement Goon—I picture him as Bluto from Popeye—would have crossed his arms, sat back in his chair, and shook his head. And had he tried to enforce *today’s* minimum wage of $7.25, well, then, it’s very likely I would have never gotten the job to begin with.

The question is: Who invited him? Why was my employment agreement anyone’s business but mine and Michelle’s?

Here’s one answer: “But it’s not voluntary! You needed the money, while the movie theater could have afforded not to hire you.”

But the fact that someone badly wants or even needs something doesn’t imply that his efforts to get it aren’t voluntary. I may have needed a job, but it’s not like Michelle could have zapped me with a cattle prod to stop me from going to work at Subway.

Michelle’s only power was the power to offer me a better deal than any of her competitors. We sometimes forget that companies have to compete for employees the same way they have to compete for customers. When I interviewed with Michelle, I was no more powerless than a consumer shopping for condiments: Heinz is free to charge a thousand bucks for a pint of mustard, but it’s not free to keep you from buying a jar of Grey Poupon instead.

Did I wish I could have gotten more than $5.35 an hour? Sure, but no one was offering me that, and as an ambitious but inexperienced worker eager to get my start, I understood why: I wasn’t *worth* more yet. I wasn’t just getting the paycheck—I was building the skills and resume that would make it possible for me to make a whole lot more than $5.35 some day.

That’s the logic behind internships, which few people object to. Young people regularly work for low and even no pay in order to build their resume, learn useful skills, and make networking connections. If you forced companies to pay interns significantly higher wages, you would achieve only one result: you would prevent young people from realizing those benefits. By the same token, if the government had stepped in and forced the movie theater to pay a wage higher than what my ability justified, it wouldn’t have magically made me more productive—it would have made me unemployable.

Those who don’t think the world owes them a living understand that they can’t expect to get paid more than the worth of their value to an employer, and that to earn more they have to become worth more. Such people know that a low-paying job can be the best path to a high-paying job. Contra the minimum wage cheerleaders, it isn’t low pay that’s unfair—it’s preventing people from offering and accepting jobs that’s unfair.

Then again, maybe it’s not those who believe in individual responsibility that the supporters of the minimum wage are trying to appeal to.