

Minimum Wage Claims Make Minimum Sense

The Labour Party is promising to increase the statutory minimum wage to \$15/hour (from its present level of \$13/hour, an increase of over 15%) if it forms the next government.

The announcement gave rise to the usual range of claims and counter-claims. Prime Minister John Key said that “if anyone thinks we can just magically increase the minimum wage with no implications for the labour market or costs to employers, they don’t understand basic economics.”

Labour leader Phil Goff argued that unemployment went down, not up, when the last Labour-led government hiked minimum wages, and that the increased spending power of workers would grow the economy.

Some simple tests help us to evaluate these claims.

If it’s a good idea to raise the minimum wage to \$15/hour, wouldn’t raising it to \$20 or \$30 an hour be even better? Those who maintain an increase has no effect usually balk at this proposition.

Alternatively, if the minimum wage is a good idea because it raises some workers’ incomes, shouldn’t we mandate increases in other incomes as well? Contractors, for example? And what about the self-employed, some of whom don’t make minimum wages?

Looking at things the other way round, why should the government intervene if a firm and a worker are willing to agree to a wage below the minimum? Should we make voluntary work and unpaid internships illegal?

And if raising the minimum wage is justified on grounds of fairness to workers, where does fairness to employers come in? A minimum wage increase may put an employer out of business. Is that fair?

Such questions are seldom confronted in the minimum wage debate.

Employees and employers are not the only parties with interests at stake. Consumers also have an interest because minimum wage increases will push up the prices of things they buy. Taxpayers will face higher taxes with state sector wage increases. Some of the unemployed will miss out on jobs that firms are unable to offer at the higher rate.

Yet the voices of consumers, taxpayers and the unemployed are seldom heard in the debate. Unions represent the interests of their employed members, not the unemployed.

Some claims make no economic sense.

Boosting the spending power of workers on minimum wages involves a transfer from the incomes of employers. It does nothing to increase production. Indeed it reduces economic growth due to job losses and other effects.

It is true that in a buoyant labour market total employment may increase when minimum wages go up. But the economic effect must be measured on the basis of 'other things being equal': how much more would employment have increased were it not for minimum wage effects?

Tapu Misa in the *Herald* argued that the economics of minimum wages was inconclusive, citing research that did not find harmful employment effects. There are often contradictory findings in any science – think climate change for example. But a big majority of economists agree higher minimum wages reduce employment among young and low-skilled workers. The intuition is simple: if you raise the price of anything, less is usually demanded.

Moreover, the effects are not confined to employment. Firms faced with higher minimum wages may reduce training, leave and other working conditions. The effects of minimum wages are sometimes hard to pick up.

Of course the harm associated with the minimum wage depends on where it is set. The problems arise when it is set above market-determined wages. Employers in competitive markets cannot pay workers more than their productivity warrants. (The idea that raising minimum wages will help close the wage gap with Australia is absurd).

The 2025 Taskforce noted that in 2008, New Zealand had the second highest minimum wage in the OECD relative to the median wage. At 59% of the median wage, it is far above the OECD average of 46%.

The Taskforce also noted the serious effect on youth unemployment of abolishing the separate youth minimum wage in 2008. For young people, getting a foot on the bottom rung of the income ladder is vital: they don't usually stay there for long. And they are far better off on a starting wage of, say, \$10/hour than on an unemployment benefit (effectively about \$4.70/hour). Minimum wages are a poor tool for alleviating poverty.

Those promoting higher minimum wages are usually well-intentioned (although history records many examples of unions promoting them to exclude competition from ethnic and unskilled groups). But good intentions are not enough when the consequences are malign.

It has been estimated that the abolition of youth rates may have cost over 9000 jobs and that an increase in the minimum wage to \$15/hour could cost a further 6000 jobs. Particularly at a time when the economy is struggling to grow and unemployment is high, such moves make minimum sense.

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