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Minimum Wage Folly Bites

The seriousness of our unemployment problem was highlighted by the labour force statistics for the June quarter.

On a seasonally adjusted basis, the unemployment rate rose to 6% of the labour force, half as much again as in June 2008. Broader measures, such as the number of jobless, also rose sharply.

The minister of finance, Bill English, warned that “unemployment is going to get worse before it gets better.” The prime minister predicted that the unemployment rate would not rise above 8%, implying a further increase of up to one-third.

Maori Party co-leader Tariana Turia referred to “the severe unemployment problem Maori and Pasifika peoples are facing”. The unemployment rate for Maori and Pacific peoples reached 12.6% and 12.8% percent respectively.

Some 36,600 people between 15 and 19 years of age – roughly equivalent to the combined populations of Timaru and Gore – are unemployed. They account for more than 1 in 5 of all people of that age actively seeking work. This is double the unemployment rate for people aged 20-24 years and almost four times that for all age groups.

Although unemployment tends to increase during downturns in economic activity, persistent unemployment is caused by other factors. These are well understood and can usually be traced to bad government policies. Legislated minimum wages are among them.

Unless potential employees can find a job paying at least the minimum wage, they cannot be employed lawfully.

The current minimum adult wage is \$12.50 an hour or \$500 a week. The new entrant minimum wage for certain 16-17 year olds and the training minimum wage are \$10 an hour or \$400 a week.

New Zealand's minimum adult wage is much higher relative to average wage levels than the minimum wage rate in the United States, which has far higher labour productivity. The latter is US\$7.25 an hour (about NZ\$10.60). It is equivalent to around 43% of the US median hourly wage. New Zealand's minimum wage exceeds 60% of median hourly earnings.

The minimum wage for under 20 year olds was equal to 60% of the adult minimum wage in 1997. People aged 16-19 years, other than certain new entrants and those in training, now qualify for the adult minimum wage.

Between 1997 and 2009 the adult minimum wage increased by 36% after adjusting for inflation, whereas the minimum wage for 16 to 19 year olds increased by a massive 127% and those for new entrants and those in training increased by 82%.

Such increases were bound to price many young people out of jobs. The folly of such a policy is starkly illustrated by the unemployment statistics.

In 1946 Nobel Laureate George Stigler implored economists to be "outspoken" about increases in minimum wages because they reduce employment. A 2007 survey reported that 73% of US labour economists agreed that the number of entry-level employees hired would decrease if the minimum wage were increased.

Faced with an increase in minimum wages, employers will reduce the number of people employed and substitute more productive workers, machines or imports for low-skilled labour. They will seek to make savings in training and other non-wage employment costs.

The evidence suggests that a 10% increase in the minimum wage will reduce employment of low-wage workers by approximately 1 to 3%.

It follows that if all minimum wages increased at the rate of increase for the minimum adult wage between 1997 and 2009, some 2,400 to 7,300 jobs

may have been lost. The loss is likely to be larger because, as noted, the minimum wage for some groups increased more rapidly.

Minimum wages are sometimes said to protect vulnerable workers from exploitation by employers. This view reflects a faulty understanding of how labour markets operate. Employers compete against other employers, and employees against other employees – not employees against employers, as commonly claimed. It is the availability of alternative employment that protects workers.

Minimum wages are sometimes promoted to alleviate poverty. Those who are denied work as a consequence are usually forced to rely on welfare. The unemployment benefit for a single person aged 18 to 24 years is generally \$181.31 a week, just 36% of the minimum wage. Concerns about poverty are best addressed through the welfare and income tax systems.

Although minimum wages are an obstacle to the employment of low-skilled workers, especially young workers, they are not the sole cause of continuing unemployment. Other misguided labour market regulations, such as restrictions on dismissals, also destroy jobs.

Government programmes such as the Job Opportunities Package are no substitute for addressing the real obstacles to employment.

Politicians such as Green MP Sue Bradford who have promoted minimum wage increases should be held accountable for their unemployment consequences.

They have denied many young people the chance to get a foot on the first rung of the employment ladder.

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