The Economics of the Minimum Wage

Andrew Jackson, Chief Economist
Canadian Labour Congress

The minimum wage debate is heating up once again, with the NDP and the labour movement strongly pushing for a minimum wage of at least $10 per hour in Ontario, at the federal level (as recently recommended by the Arthurs Report) and indeed across the country. Anti-poverty groups and the Toronto Star now strongly endorse a decent minimum wage as part of an overall anti poverty strategy.

Predictably, the growing momentum for a higher minimum wage has generated cries from business and employer-friendly governments that such a move is an “inefficient” way of fighting poverty, and will come at the cost of jobs. Ontario Finance Minister Greg Sorbara has said a $10 per hour minimum wage - enough to get a single full-time earner in a big city just above the poverty line - would cost 66,000 jobs.

With respect to the argument that minimum wages are a poor way to fight poverty, it is true that not all low-wage workers live in poor families. However, very few low-wage adults live in affluent families, and higher wages are one important building-block in comprehensive strategies to assist the working poor. There is also no good reason why workers should have to put up with very low wages simply because they are cushioned by dependency on the earnings of a partner.

With respect to the job loss argument, individual studies by economists can be and are endlessly cited on one side or other of this endless debate. However, the consensus of even the impeccably orthodox and mainstream economists at the Organization for Economic Co-operation and Development (OECD) is now that minimum wages set at “reasonable” levels do not have significant negative impacts on the employment of so-called lower-skilled adults.

The latest OECD Employment Outlook - a re-appraisal of the original 1994 OECD Jobs Strategy which was very critical of minimum wages - reports that “a moderate minimum wage is generally not a problem”, can create important incentives to work for people on social assistance, and can lower the cost to governments of supporting the incomes of working poor families. The OECD Employment Outlooks of

1998 and 2003 contain the detailed empirical studies which led to revision of the previous OECD view that minimum wages cost jobs.

Similarly, the consensus of studies on the impacts of the minimum national wage introduced by Labour in the UK has been that it had no significant impacts on employment. Part of the reason that the UK minimum wage has worked so well is that it has been gradually increased a bit faster than inflation and average earnings, reaching a new and much higher benchmark while still giving the job market time to adjust.

Similarly, most recent studies of changes in US minimum wages at the state level find minimal impacts on jobs. In October of last year, five winners of the Nobel Prize for economics and over 650 other US economists endorsed a statement saying that minimum wage increases "can significantly improve the lives of low-income workers and their families, without the adverse effects that critics have claimed."

Most of the economic studies are a little less clear on why there is little or no impact on jobs. One major reason is that minimum wages apply across sectors and geographical regions, placing no single employer at a competitive disadvantage. At the sector and local level, higher minimum wages provide benefits as well as costs to employers - lower turnover, lower training costs, and more experienced workers. Left to their own devices, low-wage employers actually pay less than they should if they really calculated the costs of a cheap and disposable workforce. Another reason for minimal job impacts is that, even if business costs increase a bit, the impact on prices is not enough to appreciably reduce demand.

While there is no hard and fast definition of a reasonable wage floor, one benchmark that has been used internationally is two-thirds of the median or mid-point hourly wage - which would be more than $10 in the case of Canada, roughly the level of Canadian minimum wages a generation ago. France, Italy and the UK all have minimum wages which are much closer to this benchmark than is the case for Canadian provinces, and many smaller European countries have de facto minimum wages at this level set by collective bargaining.

The cry from business and the right that decent minimum wages come at the cost of jobs flies in the face of the simple empirical reality that countries with relatively high wage floors compared to the national median wage do not necessarily have low rates of employment or high rates of unemployment. The proportion of full-time workers with low-wage jobs (less than two thirds of the median hourly wage) is 22% in Canada, but just 7% in Sweden and 9% in Denmark. In 2005, the employment rate (the proportion of the 15-65 age group with jobs) was actually higher in both Denmark and Sweden than in Canada. And there is, according to the OECD, no relationship between the incidence of low-wage jobs and low unemployment in OECD countries. In short, the argument of the right that countries cannot have both a decent wage floor and high employment/low unemployment is simply wrong.

Finally worth noting as a footnote is the fact that even the negative studies trotted out by employers and the right have to be read carefully. Most of the negative studies show a very small impact on total hours worked as a result of often significant increase in minimum wages. It may be the case that the fast-food industry, for example, experiences higher productivity as a result of a more stable workforce, and shaves total hours of work by a fraction. But a small negative for hours does not mean that workers are worse off, especially in low-wage sectors like fast-food and retail where there are many workers accessing those hours through part-time jobs and jobs with variable work schedules.

Think about it - if your employer asked you if you would be willing to work one hour less per week in return for a 10% hourly wage increase, what would you say? And, remember, this is the worst-case scenario.

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