“Beware Of ‘The Economist’ Promoting Minimum Wages”, Ronald Janssen

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Beware Of ‘The Economist’ Promoting Minimum Wages

Ronald Janssen, *Social Europe Journal*, 19/12/2013

Miracles, it seems, are still of this world. Last week, *The Economist*, a journal that is otherwise not known for its progressive views, took it upon itself to defend minimum wages. Moderate minimum wages, so *The Economist* claimed, “do more good than harm”.

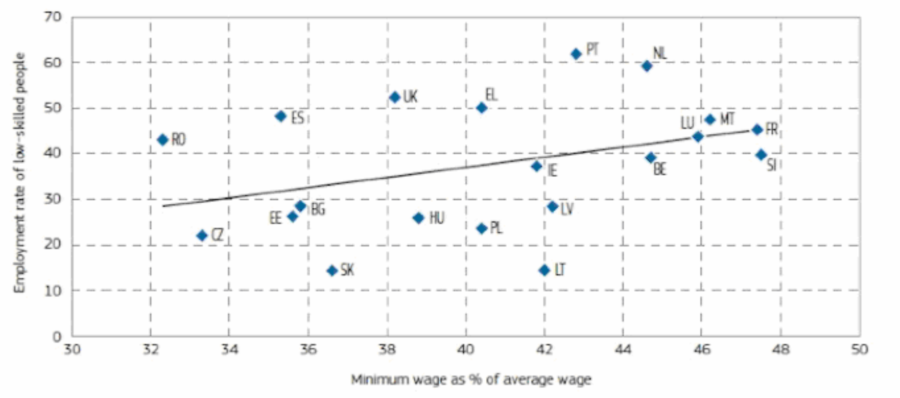
At the same time however, two important caveats were formulated: A minimum wage could boost pay without having destructive effects on jobs but only of it is set not too high. Moreover, minimum wages should be decided by technocrats, not by governments and politicians. What should we make of this?

Minimum wages and job performance

The Economist wants minimum wages to be set at a pretty low level, at no more than 50% of the median wage with even lower levels for young workers and long-term unemployed. France, having the rich world’s highest wage floor with a minimum wage of 60% of the median wage, is quoted by *The Economist* as an example not to be followed.

The graph below, taken from a Commission publication, contradicts this view. It shows that higher minimum wages tend to go together with improved employment rates for low skilled workers, the category of workers which, according to classical economic theory, would suffer the most from minimum wages acting as a barrier to job creation.

Chart 10: Minimum wage (as % of average wage) and employment rate of low-skilled workers – 2010



Source: DG EMPL calculations on the basis of Eurostat, minimum wage (earn_mw_avgr2) and employment rate [lfsa_ergaed].

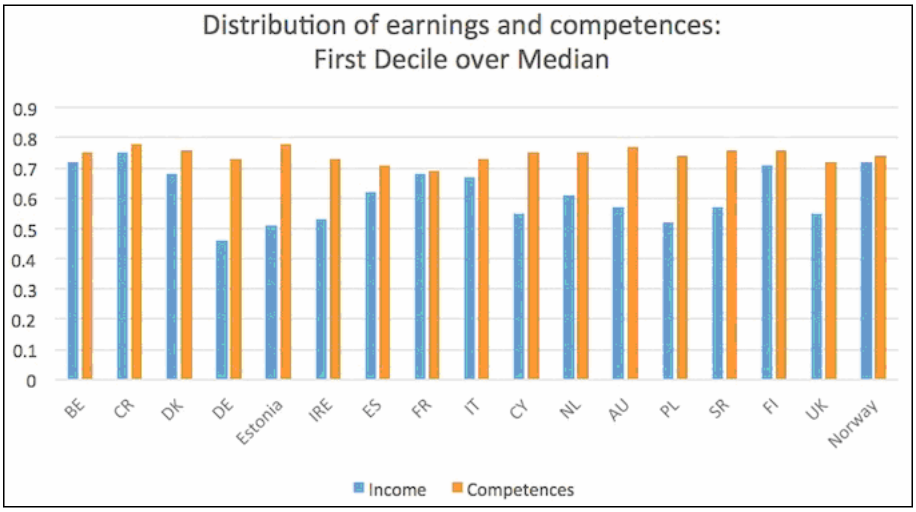
Moreover, this positive relationship between higher minimum wages and more jobs does not break down at the highest levels of minimum wages, as illustrated by the case of France. Even if France has one of the highest minimum wages, its employment rate for low skilled workers is higher compared to Poland, Hungary, Czech Republic, Ireland and on a similar level with Spain, the UK and Romania. All these countries have lower relative minimum wages compared to France. The only two countries where job performance is better are the Netherlands and Portugal. However, it cannot be claimed that these two countries have set their minimum wage substantially below the French minimum wage level.

All of this discredits *The Economist*'s argument on the perverse employment effects of a high minimum wage in France.

(Note that the Commission's graph relates minimum wages to the average wage whereas *The Economist* uses the concept of median wage. On both measures however, France scores the highest, with a minimum wage of 60% of the median wage and close to 50% of the average wage).

The statistics provided by Johannes Schweighofer's (see below) shed some light as to why minimum wages as high as 60% of the median wage do not lead to poor job performance.

These statistics compare the distribution of competences of adult workers (as measured by OECD PIAAC scores in numeracy) with the distribution of earnings. It appears that in almost all European member states, the numerical competences of the lowest ten percent of employees reach 70% to 75% of the competence level of the median employee. This would suggest that fixing wage floors for the first decile of workers as high as 70% to 75% of the median wage or income is not out of line with the distribution of skills and educational attainment. In other words, lower skilled workers in Europe do possess (in relative terms) enough numerical competences allowing them to fill in jobs that are productive enough so as to be able to finance wage floors as high as 70% to 75% of the median wage. In the next graph, I have rearranged the figures of Johannes Schweighofer on relative competences and earnings. It appears that wage floors or earnings of the lowest decile in Germany, Austria, Spain, Netherlands, Ireland, UK and several CEE member states are actually much lower if compared with the relative distribution of competences. There is no single member state where the opposite is the case and where wages and earnings at the bottom as a percentage of median earnings would be too high relative to the distribution of skills.



Source: http://www.social-europe.eu/2013/12/german-minimum-wage-jobs/

Power to the technocrats? Why The Economist is wrong

The Economist wants about giving the power to set minimum wages to technocrats. Technocrats, or so the argument goes, would advance minimum wages in a steady and gradual way whereas politicians would be prone to go for irregular but big hikes in minimum wages.

One can have some sympathy with this view, although for a different reason. Indeed, leaving the power to set minimum wages solely in the hands of governments could have unexpected effects. This is especially so in Europe where governments of the Euro Area have now signed up to the idea of internal wage devaluation in order to replace the missing instrument of a currency devaluation. In this context, minimum wages set by governments would only provide politicians an easy tool to intervene in overall wage dynamics by freezing or cutting statutory wage floors. In fact, the Commission, in its 2012 Employment

Package Communication, already announced such a use of legal minimum wage floors by claiming that minimum wages should be 'sufficiently adjustable to reflect overall economic developments'. In other words, it should be possible to cut minimum wages in case of crisis (as was done in Greece at the troika's request at the beginning of 2012 - see below "Minimum Wages in Europe under Pressure").

However, the trust which *The Economist* places in technocrats is not at all justified. In Europe, we have already outsourced monetary policy to the most independent central bank of the world, the ECB. In Europe, governments are also keen to impose a set of rigid rules upon fiscal policy and then give technical watchdogs (DG ECFIN or a Brussels based Fiscal Council) the mission to watch over the strict execution of those rules.

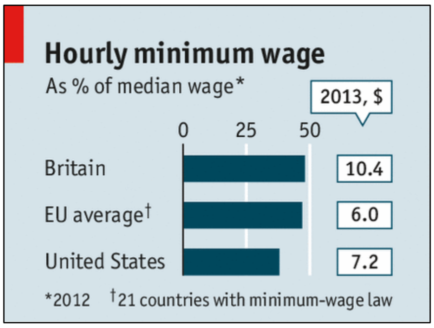
Experience with both these types of outsourcing is not particularly good. The ECB, for example, is systematically misjudging the economic situation. It has repeatedly raised interest rates while the economy was facing recession (in 2007/2008 and 2011). And, through its interventions in member states' labour markets, the ECB is now struggling with the fact that Euro Area economy is on a path towards deflation.

At the same time, fiscal policy rules as developed and promoted by European technocrats have been very helpful in pushing the Euro area economy into a double dip recession and in pushing unemployment up to a record level of 26 million unemployed.

One can expect similar developments in case minimum wages are set by technocrats. These technical bodies will soon be hijacked by the usual set of vested interests, working to submit minimum wage policy to the (non-)logic of a wage race to the bottom in the name of 'competitiveness'.

So, then, what is the solution? *The Economist* will certainly not agree but it is part of the European tradition to respect and promote the autonomy of collective bargaining and social partners. Social dialogue has the potential to achieve balanced outcomes without (minimum) wage policy being hijacked by politicians or technocrats acting on behalf of the business lobby. If politicians, technocrats and central bankers are now turning their backs to this principle of autonomy of social dialogue, they are committing a grave error, an error which threatens to unleash societal forces which we would rather not want to see reappear.

[Moderate minimum wages do more good than harm]().
They should be set by technocrats not politicians
***The Economist*, Dec 14th 2013**



ON BOTH sides of the Atlantic politicians are warming to the idea that the lowest-paid can be helped by mandating higher wages. Barack Obama wants to raise America's federal minimum wage by 40% from $7.25 to $10.10 an hour, and more than three-quarters of Americans support the idea. In Germany, one of the few big rich-world countries still without a national wage floor, the incoming coalition government has just agreed on an across-the-board hourly minimum of €8.50 ($11.50) from 2015. In Britain, which has had a minimum wage since 1999, the opposition Labour Party is keen to cajole firms into "voluntarily" paying higher "living wages".

For free-market types, including *The Economist*, fiddling with wages by fiat sets off alarm bells. In a competitive market anything that artificially raises the price of labour will curb demand for it, and the first to lose their jobs will be the least skilled—the people intervention is supposed to help. That is why Milton Friedman called minimum wages a form of discrimination against the low-skilled; and it is why he saw topping up the incomes of the working poor with public subsidies as a far more sensible means of alleviating poverty.

Scepticism about the merits of minimum wages remains this newspaper's starting-point. But as income inequality widens and workers' share of national income shrinks, the case for action to help the low-paid grows. Addressing the problem through subsidies for the working poor is harder in an era of austerity, when there are many other pressing claims on national coffers. Other policy options, such as confiscatory taxes, are unattractive.

Nor is a moderate minimum wage as undesirable as neoclassical purists suggest. Unlike those in textbooks, real labour markets are not perfectly competitive. Since workers who want to change jobs face costs and risks, employers may be able to set pay below its market-clearing rate. A minimum wage, providing it is not set too high, could thus boost pay with no ill effects on jobs.

French lessons

Empirical evidence supports that argument. In flexible economies a low minimum wage seems to have little, if any, depressing effect on employment. America's federal minimum wage, at 38% of median income, is one of the rich world's lowest. Some studies find no harm to employment from federal or state minimum wages, others see a small one, but none finds any serious damage. Britain's minimum wage, at around 47% of median income, with a lower rate for young people, also does not seem to have pushed many people out of work.

High minimum wages, however, particularly in rigid labour markets, do appear to hit employment. France has the rich world's highest wage floor, at more than 60% of the median for adults and a far bigger fraction of the typical wage for the young. This helps explain why France also has shockingly high rates of youth unemployment: 26% for 15- to 24-year-olds.

Theory and practice suggest two lessons for governments contemplating setting or changing minimum wages. The first is to ensure that the level is pretty low—say, less than 50% of the median, with lower levels for less productive people such as the young and long-term unemployed. Germany risks breaking this rule. Its proposed level is, by one calculation, 62% of the median wage. One in six German workers is paid less than that, suggesting that jobs will be lost, especially in the less productive east of the country.

Similarly the “living wage” which campaigners are calling for in Britain is 20% higher than the minimum wage. That could hit employment. Though America’s proposed increase is huge, the minimum wage would still be only about 50% of the median.

A second lesson is that politicians should give the power to set minimum wages to technocrats. In Britain, the floor is adjusted annually on the advice of economists and statisticians in the Low Pay Commission; it has generally advanced gradually. In America, the federal floor is set by politicians and adjusted irregularly in huge increments. That does no favours to American workers or their employers.

Finally, governments should remember that minimum wages are a palliative. They should not distract attention from more fundamental causes of low wages—such as a lack of education and skills—and the efforts to address them.

The German Minimum Wage – Will It Destroy Jobs?

Johannes Schweighofer, *Social Europe Journal*, 16/12/2013

German Minimum Wage – From 2017 onwards, there will be an overall statutory minimum wage of €8.50 in Germany. As a consequence of this landmark decision of the incoming Grand Coalition, there will be an increase in the unemployment rates of unskilled workers – yes or no? Economists tend to answer the question in the usual way: it depends on the circumstances! This is true, for sure. The main variables in this debate are wage rates and individual productivity. The mainstream argument goes as follows: if wages are set at a too high level you will price out unskilled workers, i.e. you will cause unemployment. Unfortunately, good individual productivity data are scarce. So, let’s have a look at proxy variables! We will proceed in two steps.

1. The distribution of earnings and competences: Distance to median

As shown in Figure 1 and Table 1, the distribution of earnings is by far more uneven than the distribution of competences. Let’s have a closer look at the German case: gross monthly earnings for full time work is at €2,728, with a bottom line (1. decil) at €1,243 and top incomes (9. decil) at €5,126. In clear contrast to this uneven distribution are PIAAC scores in numeracy which seem to be the more relevant domain for labour market issues. The low performers again measured at the 1. decil level achieve 201.9 points on a scale ranging from 0 – 500 and the high performers 335.0. The uneven distribution can be seen if the 1. decil and the 9. decil are compared according to their distance from the median. In Germany, the high performers in numeracy are 21% better than their colleagues at the median, but they earn 88% more. And the opposite is true at the bottom of the distribution: the low performing participants earn only 46% of the median incomes but achieve a score at 73% of the median. As has been said already: the distribution of earnings is by far more uneven than the distributions of competences!

Figure 1: Distribution of Monthly Gross Earnings (Fulltime) and PIAAC-Scores (Numeracy): Distance from Median

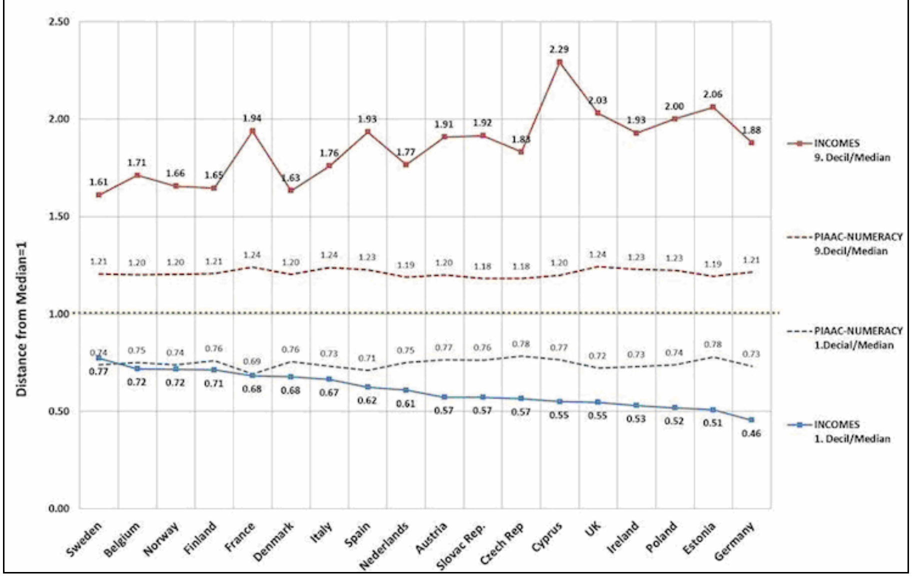


Table 1: Distribution of Earnings and Competences

	Monthly Incomes (Fulltime)					PIAAC-Scores in Numeracy				
	1. Decil	Median	9. Decil	1.Decil/ Median	9.Decil/ Median	1.Decil/ Median	9.Decil/ Median	1. Decil	Median	9. Decil
Belgium	1,960	2,727	4,667	0.72	1.71	0.75	1.20	213.7	284.4	341.5
Czech Rep.	440	777	1,423	0.57	1.83	0.78	1.18	218.4	278.4	329.4
Denmark	2,691	3,970	6,482	0.68	1.63	0.76	1.20	213.4	282.0	339.5
Germany	1,243	2,728	5,126	0.46	1.88	0.73	1.21	201.9	275.9	335.0
Estonia	356	700	1,443	0.51	2.06	0.78	1.19	214.8	275.3	328.7
Ireland	1,637	3,085	5,951	0.53	1.93	0.73	1.23	189.5	259.6	318.8
Spain	1,053	1,687	3,263	0.62	1.93	0.71	1.23	177.8	250.3	307.4
France	1,481	2,166	4,200	0.68	1.94	0.69	1.24	179.7	259.2	321.5
Italy	1,352	2,033	3,578	0.67	1.76	0.73	1.24	182.9	249.3	309.1
Cyprus	885	1,609	3,689	0.55	2.29	0.77	1.20	205.1	267.8	321.3
Nederlands	1,743	2,861	5,052	0.61	1.77	0.75	1.19	214.6	285.8	339.7
Austria	1,327	2,315	4,418	0.57	1.91	0.77	1.20	212.9	278.2	334.1
Poland	344	663	1,327	0.52	2.00	0.74	1.23	194.0	262.6	321.8
Slovac Rep.	374	653	1,251	0.57	1.92	0.76	1.18	214.3	280.4	331.4
Finland	1,929	2,706	4,455	0.71	1.65	0.76	1.21	217.4	285.8	345.0
Sweden	2,065	2,673	4,306	0.77	1.61	0.74	1.21	209.9	284.0	342.8
UK	1,348	2,462	5,001	0.55	2.03	0.72	1.24	191.6	265.0	329.3
Norway	3,100	4,323	7,160	0.72	1.66	0.74	1.20	209.6	283.5	341.4

Source: OECD PIAAC 2013, Eurostat Structure of Earnings Survey 2010

2. German Minimum Wage
The PIAAC scores in numeracy as a proxy for general productivity

In the second step of the argumentation we assume, firstly, that PIAAC scores in numeracy can be used as a proxy for a general productivity level, i.e. productivity not specific to particular jobs. And, secondly, that in the middle of the distribution incomes and productivities go hand in hand. If this is the case, than we can conclude:

a) In Sweden, for example, an increase in wage rates of low incomes would lead to unemployment because of comparatively high minimum wages.

b) This would not be the case in Germany. Here is room for maneuver to increase minimum wages. For many workers, this increase of their wage rates would be in line with their productivities. So no need for concern!

c) In stark contrast to the situation at the bottom line is the situation for high income workers: earnings are far higher than productivity!

A rather unfair situation.

Minimum Wages in Europe under Pressure

Ronald Janssen, *Social Europe Journal*, 09/10/2012

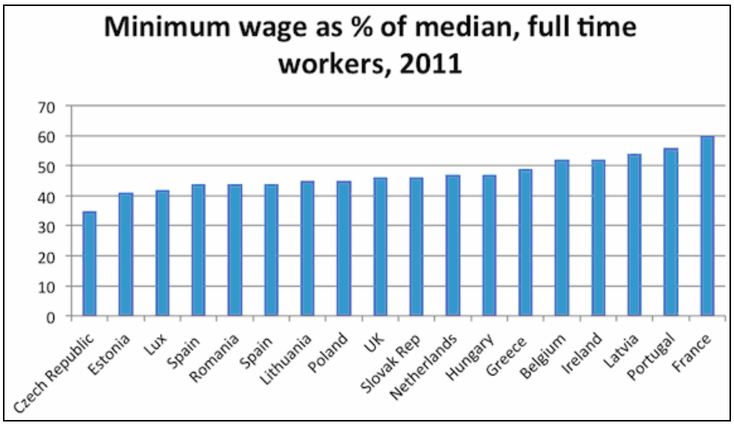
In a joint report to the G20 Labour ministers meeting in June 2012 the IMF, OECD and World Bank together with the ILO managed to produce some remarkably ambiguous language concerning minimum wages.

First, there is a positive message: statutory minimum wages may raise labour participation, sustain demand and reduce poverty and all of this without destroying jobs. Given the IMF's and the OECD's reputation of busting all types of labour regulation, this statement in defense of minimum wages is quite revolutionary. Unfortunately, the report goes on to say that if wage floors are set at a level that is significantly higher than appropriate, the positive effects on demand and inequalities risk more than being offset by lost job opportunities, especially for youth and low skilled workers. In other words, high minimum wages kill jobs.

Two months earlier in its 'Employment Package' Communication, the European Commission adopted an almost identical approach. In what now appears to be an implicit attempt to support the introduction of a minimum wage in Germany, the Commission backed the general principle of a wage floor while also attaching three conditions: minimum wages need to be set at an appropriate level, be 'sufficiently adjustable' to reflect overall economic developments (in a downwards direction?) and to be 'differentiated' in order to uphold labour demand.

While the Commission Communication refrains from defining exactly what an 'appropriate' minimum wage level would look like, the joint IMF/OECD/ILO report to the G20 Labour ministers did propose a precise range of a minimum wage between 30% and 40% of the median wage. Minimum wages below that range would increase inequality and undermine aggregate demand. On the other hand, minimum wages above 40% of the median wage destroy jobs, thereby worsening poverty and inequalities. Here, one cannot avoid the impression that a sort of football game is going on, with the ILO and the Commission's employment and social policy directorate passing the ball to the IMF and OECD who then have kicked the ball into the goal. Events at the Commission's recent Employment Conference in early September strengthen this impression, with keynote speaker and recent Nobel prize winner Christopher Pissarides openly pleading in favour of 'low' minimum wages and the general secretary of the OECD Angel Gurria claiming that 'there's massive evidence that high minimum wages destroy jobs'.

All of this is a clear step backwards. Indeed, statutory minimum wages across Europe are systematically higher than the threshold defined by the G20 institutions. They start from 45% of the median wage in Poland, going up to 60% in France (see table; source: OECD, ETUI). It's only in the Czech Republic and Estonia that the minimum wage falls in this so-called appropriate range.



So in reality, this institutional discussion on the general desirability of minimum wages boils down to a vicious attack on existing minimum wage systems across the majority of Europe. This neatly fits in with the strategy of internal devaluation that finance ministers and central bankers are now in the process of implementing in the Euro Area, replacing the missing instrument of a currency devaluation with deflationary wage cuts. In such a strategy, decent wage floors are seen as an obstacle blocking the downwards adjustment of wages that member states need in order to restore competitiveness. By attacking the existing levels of minimum wages, even the lowest wages are transformed into a factor of competitive adjustment.

The joint G20 report does not provide any supporting evidence whatsoever for the claim that minimum wages higher than 40% of the median wage would destroy jobs. In fact, if we look at other studies published by the same institutions that co-signed the G20 report, we actually find evidence to the contrary. For example, the 2006 update of the OECD's Jobs Study concluded that 'a considerable number of studies have concluded that the adverse impact of minimum wages on employment is modest or non-existent' (OECD Employment Outlook 2006, page 86).

Another study, undertaken by the ILO and referred to in a footnote in the G20 report states that 'empirical studies (…) have so far failed to find any significant correlation between the minimum wage and employment' (page 26). Moreover, the ILO study examines experiences with minimum wages in 13 European countries and finds no adverse effects on employment in Ireland, the UK, Greece, Sweden, Bulgaria and the Baltics. For countries where policy achieved a (relative) fall in minimum wage rates (Netherlands) or systematically promoted low-wage jobs (Germany), the conclusion is that this did not improve overall employment but simply replaced jobs in the middle income range with low paid jobs. In other words, bad jobs drove out good jobs without creating new net jobs.

The only warning the ILO study provides is on the issue of timing. In a reference to the doubling of the minimum wage in Hungary in 2001-2002, the ILO insists on the condition that minimum wages are to be adjusted in a progressive and regular way. That, however, is quite different from the G20 recommendation to keep the level of minimum wages at a low and indecent level.

Finally, a fundamental remark is that this policy discussion on a 'one size fits all' threshold does not make much sense. From a static point of view, everything depends on the distribution of skills, education and training. If that distribution is more equal, minimum wages can be substantially high and even need to be so in order to avoid possible situations of exploitation. From a dynamic point of view, the adjustment mechanism that policy should be using is to upgrade skills and workplace practices, not the downgrading of wages that are already low. Here, robust minimum wages can actually function as an incentive for employers, pushing them to reorganize the workplace in a better and more efficient way. Here's another quote from the ILO: 'The Low Pay Commission in the UK has insisted on the role of the minimum wage in encouraging firms to compete on the basis of quality as well as price; helping to promote employee commitment, reduce staff turnover and encourage investment in training, thereby boosting productivity and aiding company competitiveness' (page 29). In their obsessive drive to install ultra wage flexibility across Europe and the Euro Area, the international institutions are ignoring these dimensions and functions of minimum wage policy.