**Minimum wages**

**The logical floor**

*Moderate minimum wages do more good than harm. They should be set by technocrats not politicians*

From The Economist (British) magazine

Dec 14th 2013 edition

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 (see article). 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.