

High minimum wage kills jobs and makes poor worse off

Monday, 31 March, 2014

By Steve H. Hanke

US President Barack Obama set the chattering classes abuzz after his unilateral decision to raise the minimum wage for newly hired federal contract workers.

“It’s good for the economy, it’s good for America,” he said in his recent State of the Union address.

As the worldwide economic slump drags on, the political drumbeat to either introduce minimum wage laws (read Germany) or increase the minimums in countries where these laws already exist – such as Indonesia – is becoming deafening.

Yet the glowing claims about minimum wage laws don’t pass the most basic economic tests. Just look at the data from Europe.

There are seven European Union countries in which no minimum wage is mandated – Austria, Cyprus, Denmark, Finland, Germany, Italy and Sweden. Compare the levels of unemployment in those countries with EU nations that impose a minimum wage and the results are clear – a minimum wage leads to higher levels of unemployment.

In the 21 countries with a minimum wage, the average country has an unemployment rate of 11.8 per cent. The average unemployment rate in the seven countries without mandated minimum wages is about one-third lower – 7.9 per cent.

This point is even more pronounced when looking at rates of unemployment among the EU’s youth – defined as those younger than 25 years of age.

In the 21 EU countries where there are minimum wage laws, 27.7 per cent of the youth demographic – more than one in four young adults – was unemployed in 2012.

This is considerably higher than the youth unemployment rate in the seven EU countries without minimum wages – 19.5 per cent in 2012 – a gap that has only widened since the Lehman Brothers collapse in 2008.

So, minimum wage laws, while advertised under the banner of social justice, do not live up to the claims made by those who tout them.

They do not lift low wage earners to a so-called “social minimum”. Indeed, minimum wage laws – imposed at the levels employed in Europe – push a considerable number of people into unemployment.

And, unless those newly unemployed qualify for government assistance (read welfare), they will sink below, or further below, the social minimum.

As Nobel Prize winner Milton Friedman correctly quipped: “A minimum wage law is, in reality, a law that makes it illegal for an employer to hire a person with limited skills.”

The real tragedy of minimum wage laws is that they are supported by well-meaning groups who want to reduce poverty. But the people who are hurt most by high minimums are the most poverty-stricken

Milton Friedman, Nobel laureate for economics

Jens Weidmann, president of Germany’s Bundesbank, must have heard Friedman and looked at these European data before he took on Chancellor Angela Merkel for proposing the introduction of a minimum wage law in Germany.

In short, Weidmann said that this would damage Germany’s labour market and be a job killer.

He is right.

Executives surveyed in the recently released Duke University/ CFO Magazine global business outlook survey agree Chief financial officers from around the world were interviewed, and a significant number of them concurred: a minimum wage increase in the United States – from US\$7.25 per hour to Obama’s US\$10.10 per hour – would kill US jobs.

“The real tragedy of minimum wage laws is that they are supported by well-meaning groups who want to reduce poverty. But the people who are hurt most by high minimums are the most poverty-stricken,” Friedman concluded.

High mandated minimum wages will throw people out of work and onto the welfare rolls, in cases where unemployment benefits exist.

When it comes to welfare payments, they obey the laws of economics, too. Indeed, if something – like unemployment – is subsidised, more of it will be produced.

When the data on unemployment benefits speaks, it tells us that if the unemployed receive unemployment benefits, the chances that they will become employed are reduced.

That data also shows that the probability of an unemployed worker finding employment increases dramatically the closer the unemployed worker comes to the termination date for receipt of unemployment benefits.

In short, when the prospect of losing welfare benefits raises its head, unemployed workers magically tend to find work.

The most important lesson to take away from allowing the minimum wage and unemployment benefit data to talk is that abstract notions of what is right, good and just should be examined from a concrete, operational point of view.

A dose of reality is most edifying.

Steve H. Hanke is professor of applied economics at Johns Hopkins University. He is also a senior fellow and director of the Troubled Currencies Project at the Cato Institute in Washington

Links:

- [1] <http://www.scmp.com/news/china-insider/article/1417264/china-news-round-beijing-raises-minimum-wage-cigarette-sales-ads>
- [2] <http://www.scmp.com/business/economy/article/1376353/minimum-wage-can-benefit-hong-kong-says-nobel-laureate>
- [3] <http://www.scmp.com/business/economy/article/1353825/talk-minimum-wage-fuels-job-fears-germany>
- [4] <http://www.scmp.com/comment/letters/article/1299097/high-rents-not-minimum-wage-are-main-reason-rising-prices>
- [5] <http://www.scmp.com/lifestyle/technology/article/1296909/technology-threatens-cheap-labour-after-adoption-minimum-wage>