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Let's have an honest debate on minimum wage

In a recent article Peter Holle argued that increasing the incomes of poorer workers should be done by reducing their income tax rather than increasing the minimum wage. Decreasing taxes on the poorest in society is an excellent idea. However, why these two policies should be seen as substitutes rather than complements is never really explained. Further, in the process of advocating the tax reduction Holle repeats some commonly held myths about the impacts of the minimum wage.

The available evidence on the impact of minimum wage on the labour market is much more mixed than Holle, or the study by David Pankratz on which his article is based, would lead us to believe. For example, Pankratz claims that the consensus in the economic literature is that a 10% increase in the minimum wage would reduce teenage employment by around 1% to 3%. However, this "consensus" is not nearly as consensual as Holle or Pankratz claim. Their evidence is drawn from a few studies in the 1980s but a 2001 article in the Journal of Economic Education by Alan Krueger found much more evidence to support the lower 1% reduction than the 3%, and more recent studies estimated an even lower 0.6% effect. In fact, the Pantratz study, and Holle's article, only provide a one-sided picture of a very real debate in the economics profession about the impacts of the minimum wage.

The most recent debate over the minimum wage stems from a paper written in 1994 by David Card and Alan Krueger. They used an increase in the minimum wage in New Jersey from $4.25 to $5.05 as a real-life experiment to test the effects of the increase on employment in fast-food firms, which they used as an example of low-wage labour. Much to the surprise of many economists, they found that the increase in minimum wage had no significant employment effects. This finding, which Holle fails to mention, sparked a debate in the 2000 American Economic Review. David Neumark and William Wascher argued that the 1994 study used faulty data that led the authors to a mistaken conclusion. In their estimate of the same minimum wage hike on the same industry, using their improved data set, Neumark and Wascher found that employment did fall. Given a chance to respond in the same journal issue, Card and Krueger took issue with the data used by their critics and, pulling out their own new and improved data set, estimated both the impact of the New Jersey increase in the minimum wage

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and the increase in the federal minimum wage in 1996 from $4.24 to $4.75. Their findings in both the New Jersey and federal examples supported their 1994 conclusions that "modest changes in minimum wage have little systemic effect on employment".

The minimum wage controversy and the wrangling over superior data sources certainly highlight the difficulty of empirical testing in the social sciences. However, at the very least, it is also possible to conclude that there is considerable doubt about whether the minimum wage actually increases unemployment among low-wage workers. Perhaps this is the reason that a recent survey by David Colander of economics graduate students in six leading US schools and published in The Journal of Economic Perspectives found that only 34% agreed with the statement, "A minimum wage increases unemployment among youth and unskilled workers".

The debate about the employment effects of an increase in the minimum wage is far from an empirical quibble among the pocket-protector set. If the percentage decrease in the number of people employed is less than the percent change in wages ("inelastic," in economic terminology), then an increase in the minimum wage will lead to an overall increase in income for the low-wage group. This would indicate that increasing the minimum wage would, far from increasing poverty, actually reduce it, since the wage gains of the many who remain employed would outweigh the losses of those few who become unemployed.

Given the recent empirical research on the minimum wage, it seems strange that authors continue to argue that it is a horribly misguided policy. Part of the reason is probably that a strong connection between minimum wage and unemployment is theoretically consistent with the supply and demand model at the core of price theory in economics. To the delight of free market economists, it also provides an excellent textbook example of the "danger" of government intervention in the functioning of the market. However, its theoretical attractiveness is not the only explanation for the continuing assertion that minimum-wage increases are detrimental to low-income workers. Free-market research institutes, such as the Cato Institute in the US and The Fraser Institute in Canada have been very vocal in their condemnation of any increase in the minimum wage. While opposition to any government intervention in the functioning of the market is consistent with the free-market ideology of these think tanks, it is also conveniently in keeping with the interests of their corporate donors.

Surely an honest debate around all the pertinent economic literature would be more in the public's interest.

Ian Hudson is an associate professor of economics and the University of Manitoba and a CCPA MB. research associate. For more on the minimum-wage and other economic debates, see the recently released book: Social Murder and other shortcomings of conservative economics by Ian Hudson and Robert Chernomas.

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