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Minimum Wages: Good Politics, Bad Economics?

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Contents

An Introduction to

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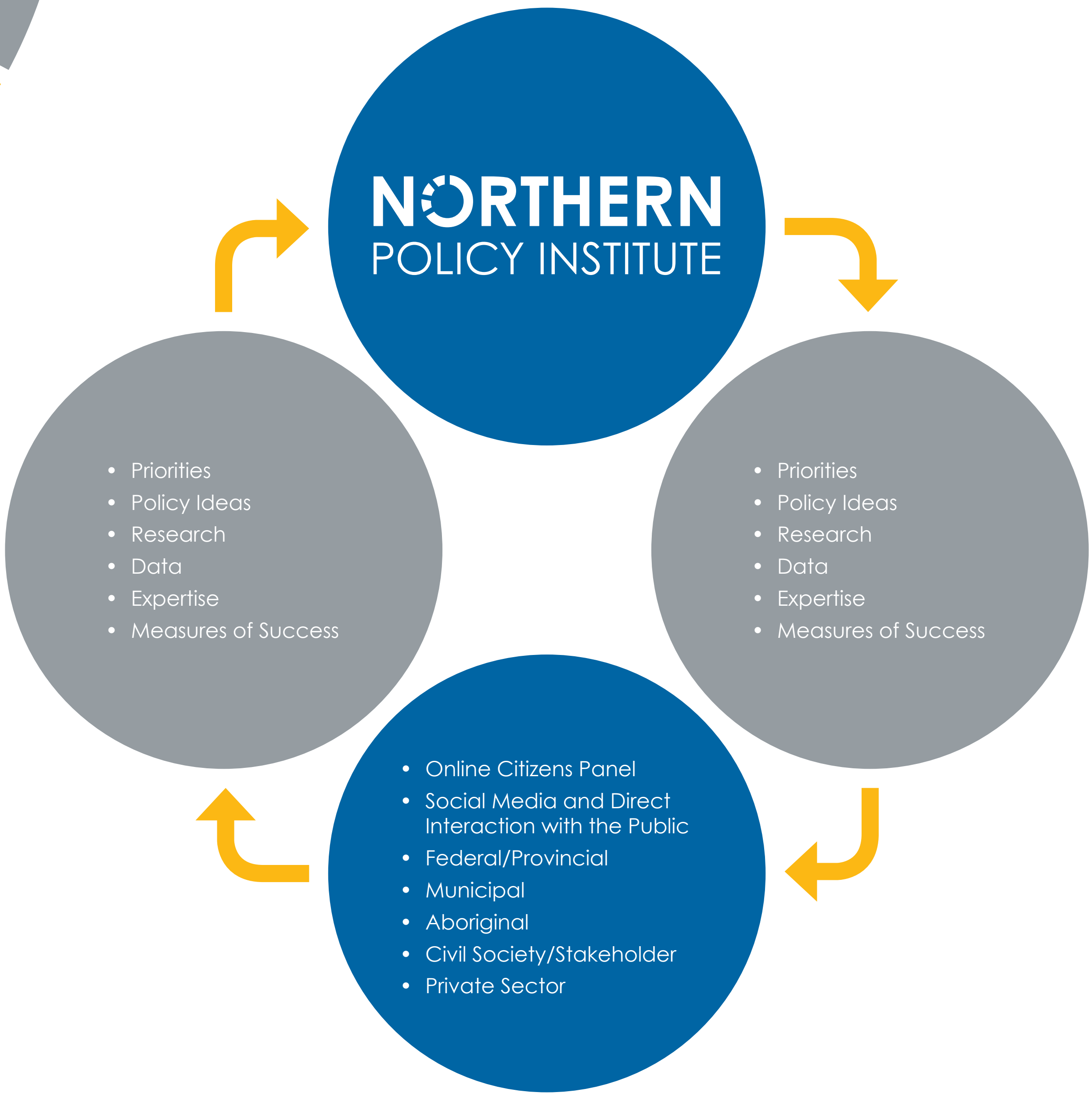

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About the Author

Morley Gunderson

Dr. Morley Gunderson is a professor at the Centre for Industrial Relations and Human Resources, and Department of Economics at the University of Toronto. He is also the CIBC Chair in Youth Employment.

The University of Toronto established the Morley Gunderson Prize in 1997 as a tribute to Morley Gunderson's 10 years as Director of the Centre for Industrial Relations and Human Resources.

In 2008 Professor Gunderson was inducted as a Fellow of the Royal Society of Canada for his work as an internationally recognized scholar whose research, institution building and teaching transformed the field of Industrial Relations in Canada from one that was formerly descriptive and institutional to one that uses rigorous quantitative and analytical techniques.

Executive Summary

Increasing the minimum wage tends to be very popular with the general public and so is equally popular with politicians eager to secure the support of that public come election time. However, Morley Gunderson outlines here, yet again, that good politics does not necessarily translate into good economics. This paper addresses a series of inter-related issues revolving around the political appeal of minimum wages, the profiles of minimum wage workers in Canada, and the effects of minimum wage increases, to best determine policies for adjusting minimum wages.

Minimum wage increases are politically appealing as they tend to be rationalized as an anti-poverty tool. The image is often portrayed of a poor person working full-time at the minimum wage but earning less than a poverty line level of income. Thus, the "upside" of a higher minimum wage seems immediate and apparent – higher wages for low-wage persons. However, the more subtle and less visible subsequent negative effects – the most notable being *adverse employment effects* – are largely downplayed in public discourse.

To understand this concept, it is crucial to first examine *who* works at the minimum wage. In Canada, the majority of minimum wage workers are teens or youths who live at home with their parents, often students who work in part-time jobs. Many other minimum wage workers have spouses who earn above the minimum wage. The family as a whole does not live in poverty and so the people most likely to benefit from a rise in minimum wage are not, by and large, the working poor. In effect, minimum wage increases fail to achieve the fundamental goal used to justify them – minimum wage increases do not reduce poverty in Canada. Additionally, the subsequent (or unintentional) effects do indeed harm those that actually are living in poverty.

Minimum wages can have an *adverse employment effect* by reducing the demand for workers whose wages have increased. This can occur as employers substitute other inputs for the low wage labour whose wages have increased. Seeing that teens are the majority of minimum wage workers, Canadian evidence has shown that a 10% increase in the minimum wage would lead to a 3% - 6% reduction in the employment of teens. Increasing minimum wages results in greater unemployment, and unemployment reduces total family income, pushing more families into poverty or making those who were already poor, worse off.

For these and other reasons, Gunderson recommends that: i) the discourse around minimum wages needs to place more emphasis on the adverse employment effects; ii) increases should be flexible and dependent on the state of the economy; iii) adjustments should be continuous small increases rather than large and infrequent; and iv) minimum wage increases should not be used as a poverty reduction tool.

Minimum Wages: Good Politics, Bad Economics?

Minimum wages and their increases have extensive appeal to the general public and hence to politicians who rely on the public for their votes. But, as argued in this paper, good politics does not mean good economics. This will be illustrated by highlighting the minimum wage issue through addressing a series of inter-related questions: Why are minimum wages so politically appealing? What are the characteristics of workers who would be affected by minimum wage increases? What are the *potential* effects of minimum wages? Are there possibly *offsetting factors* that could mitigate any adverse effects? What are the *actual* effects based on the empirical evidence? Are there better alternatives? What are the best policies with respect to the minimum wage?

Why Are Minimum Wages so Politically Appealing?

Minimum wage legislation tends to be rationalized as an anti-poverty device. This is the case both historically and currently in Canada (Battle 2011; Gunderson 2005) as well as internationally (OECD 1998). The 2008 Ontario Budget (p. 46) indicated that increasing the minimum wage to $10.25 by 2010 was part of the "government's early initiatives to help reduce poverty." In July 2013, the Ontario government appointed an Advisory Panel to advise on minimum wage increases. Much of this has been prompted by pressure to use minimum wages as a tool to fight poverty (Verma, 2014, p.5).

In the United States, increases in the minimum wage have been endorsed by populist politicians largely as an anti-poverty device. In 1998, President Clinton indicated that the minimum wage "will raise the living standards of 12 million hard-working Americans" and Senator Kennedy indicated that "the minimum wage was one of the first – and still one of the best – anti-poverty programs we have."[1] Barack Obama in his first campaign for the presidency endorsed raising the minimum wage so that "people who work full-time should not live in poverty" (Sabia and Burkhauser 2008 p. 5). He has continued that endorsement in more recent speeches.

The political and popular appeal for minimum wage increases rests on a number of factors. The "upside" seems immediate, apparent and concentrated in the hands of a few – higher wages for low-wage persons who keep their job. The "downsides" are more subtle and less visible (detailed subsequently) including fewer job opportunities for youth. The image is often portrayed of a poor person working full-time at the minimum wage but earning less than a poverty line level of income. If wages are deemed "too low" then the solution seems simple – raise them by legislative fiat. Higher minimum wages may induce people to leave welfare and look for work and, if they get a job, to "earn" their income rather than receive it in the form of transfer payments.

Minimum wages have received renewed interest given other developments that have occurred in the labour market. The rise in income and wage inequality has drawn attention to those at the bottom of the wage distribution, especially given their comparison to those at the top. The labour market is increasingly polarized into "good jobs" and "bad jobs" with the latter often involving non-standard employment in various forms: part-time work; seasonal work; casual, temporary work on limited-term contracts; self-employment; temporary-help agencies; on-call work; telecommuting and home working (Fortin, et. al., 2012; Vosko 2010). Concern has also been expressed over the working poor—those who work full-time and full-year but do not earn sufficient income to bring them out of poverty. Union power and influenced has also declined in the private sector under pressures of global competition. As such, minimum wages are often regarded as giving protection to those at the bottom of the earnings distribution who otherwise have no individual bargaining power.

Interest groups often support minimum wage legislation to further their own ends. Large employers may support minimum wages if they already pay above the minimum wage since the higher wages may adversely affect their competitors who pay below the minimum. Unions may support minimum wages out of a genuine belief that it will help low-paid workers, but it is also the case that it will reduce competition against unionized workers who are invariably paid above a minimum wage.

Clearly there is a wide range of factors that make minimum wage legislation politically appealing. Many of these involve legitimate areas of concern. But what makes good politics does not necessarily make good economics. The political appeal rests on the logic of collective action (Olsen 1965); that is, the gains are concentrated in the hands of a few who have a vested interest in pressuring their case, while the costs are diffused over a broader population for whom this is only one of many issues. Consistent with its being labeled "the dismal science", however, economics emphasizes the "law of unintended consequences." This is aptly illustrated with respect to minimum wages where subtle and less visible adjustments can lead to negative effects and harm the very persons they are designed to help.

1 These sources are cited in Neumark and Wascher (2008, p. 141). Card and Krueger (1995) and Sabia and Burkhauser (2008) also discuss the history and political support for minimum wages as an anti-poverty device.

What are the Characteristics of Minimum Wage Workers?

The characteristics of workers who work at or near the minimum wage is revealing in terms of who would be affected either positively or negatively by minimum wage increases, and the potential for minimum wages to alleviate poverty. Based on Labour Force Survey data for Canada, Battle (2003) highlights the following characteristics of minimum wage workers:

- Fewer than 3% of workers between the ages of 25-64 work in minimum wage jobs in Canada. Since this is the age group that is most likely to constitute the working poor, this suggests that minimum wages are not likely to make a substantial contribution to alleviate poverty amongst the working poor.
- About 60% of minimum wage workers are teens or youths who live at home with their parents.
- About 25% are couples and of these only about one-quarter (i.e., about 6%) do not have a spouse that is employed in a job above the minimum wage, with about three-quarters (i.e., about 18%) having a spouse employed at a job above the minimum wage.
- 11% are unattached individuals.
- 4% are single heads of families.

Battle (2012) also indicates that minimum wage workers tend to be less educated and especially high-school dropouts. This highlights that policies to improve their skills through more education including apprenticeships and vocational training may be viable alternatives for increasing their skills and hence their wage and employability. Minimum wage workers tend to be in industries like accommodation and food services (where tips are a common form of compensation), agriculture, and wholesale and retail trade. They are often students, work in part-time jobs, have little job experience, and are not members of a union. A similar picture emerges based on more recent data for Ontario (Verma, 2014). That report also indicates that in 2012, 9.3% of workers in Ontario had wages that were at or below the minimum wage.

Overall, these characteristics suggest that minimum wages are poorly targeted towards helping relatively disadvantaged workers including the working poor. This also applies to those just above the minimum wage who may see their wages rise as well.[2] Minimum wages do not help many poor persons because only small portions of the group that constitutes the working poor work in minimum wage jobs. Even for those working poor who work in minimum wage jobs, a typical minimum wage increase would raise their income only slightly and perhaps even lower their income if their employment or hours of work were reduced (discussed subsequently). Any income increase could also be mitigated by the "claw-backs" that can exist whereby transfer payments they may receive as poor persons are reduced as their income increases. Furthermore, spillover effects to the non-poor are substantial as evidenced by the fact that the majority of minimum wage workers are teens or youths who live at home with their parents, or they are students who work in part-time jobs and many are in families with a spouse who earns above the minimum wage.

This poor targeting has increased over time given changes that have occurred in the labour market that have weakened the already weak relationship between low wages and poverty. That relationship has always been weak because wages refer to the *hourly* pay for an *individual* while poverty relates to *family income* relative to family *need*. Family income consists of *wages* times hours of *work* for the *various* family members who are *employed,* plus *non-labour income*. Clearly, the wages of one individual are only a small component of that income, and it may be unrelated to family need. Hourly pay for an individual may not contribute much towards family income if the individual works few hours or has intermittent employment or is at risk of not having a job or has other family members who work or receive other forms of income. As well, the hourly pay of an individual need not be related to the needs of the family. This already weak connection between the hourly wages of an individual has been weakened further by the increased number of families with multiple-earners and the increased number of students working in the growing service economy.[3] This poor targeting of minimum wages towards the disadvantaged and those in poverty is emphasized in much of the literature on minimum wages.[4]

2 The evidence suggests that such cascading or spillover effects are small and confined to those just above the minimum wage. See, Card and Krueger (1995, p. 160-66), Cox and Oaxaca (1981), Gramlich (1976), Grossman (1983) and Katz and Krueger (1992).

3 This weakening over time between low wages and poverty is documented and discussed, for example, in Burkhauser and Finegan (1989), Burkhauser, Couch and Glenn (1996), Burkhauser and Sabia (2004, 2007) and Sabia and Burkhauser (2010).

4 The poor targeting of minimum wages towards those in poverty in the US is documented and discussed, for example, in the studies mentioned in the previous footnote as well as in Freeman (1996), Gramlich (1976), Neumark and Wascher (2002, 2008), Smith and Vavrichek (1992) and Veeder and Gallaway (2001), and for Canada in Benjamin (1996, 2001), Campolieti and Gunderson (2010), Gunderson (2005), Mascella, Teja and Thompson (2009) and Sen et al., (2011).


Annuals

What are the *Potential* Effects of Minimum Wages?

This section of the report outlines the *potential* effects of minimum wages, with the evidence on the *actual* effects presented in the next section.

The most obvious effect of minimum wages is the *immediately visible effect* of raising the wages of those who work between the old minimum wage and the new minimum wage.[5] But this highlights the very problem – the initial effect is immediate and visible. The longer run effects are subtle and less visible, highlighting what economists term the "law of unintended consequences." Evidence on these impacts will be provided in the subsequent section on *actual* effects. This section outlines the mechanisms whereby minimum wages can have an impact.

Minimum wages can have an *adverse employment effect* by reducing the demand for workers whose wages have increased. This can occur as employers substitute other inputs for the low wage labour whose wages have increased. The substitution will not likely be overt and immediate in the form of layoffs or dismissals; rather it will likely occur in more subtle and less visible forms such as hiring freezes or reduced new hiring or fewer job opportunities for such low-wage workers (and these are less likely to attract popular or political attention). These subtle adjustments can occur as employers substitute other inputs or processes for the higher priced workers: self-service cafeterias replacing waiters and waitresses; self-service gas pumps replacing service station attendants; self-service checkout counters and automated inventory systems replacing clerks; on-line purchasing replacing retail clerks; fast food automation replacing conventional restaurant staff; pre-packaged food replacing food handlers in local grocery stores; pre-packaged goods replacing staff in local hardware stores; "disposable" consumer goods replacing repair persons; low maintenance buildings replacing custodial and maintenance workers; and offshore outsourcing and imports produced by low-wage foreign labour replacing domestic workers.[6] The adverse employment effect can be further fostered by employers having to reduce their output in response to their higher costs, perhaps in the form of the slower growth of firms experiencing the wage increases.

The adverse employment effect can lead to longer-run negative consequences in the form of *scarring effects* if youths experience initial negative bouts of unemployment when they first enter the labour market.[7] They may become disillusioned with the world of work that they feel may have turned its back on them, and their initial bouts of unemployment may be regarded as a stigma in terms of employers subsequently hiring such youth.

The adverse employment effect can also occur in the form of *reduced hours* as well as, or in addition to, reduced employment opportunities. Again, this can occur in subtle forms such as substituting part-time work for full-time work or reductions in overtime work.

Minimum wages can also *reduce the training opportunities* for workers to the extent that workers were willing to work in lower wage jobs that provided training or experience that would enhance their subsequent earnings. Most minimum wage jobs are temporary stepping-stones for youths who acquire the experience and on-the-job training that enables them to advance to higher paying jobs.[8] It is ironic that we ban such a trade-off of firms providing training in return for paying low wages, but we often encourage *unpaid* internships to allow youths to acquire training and experience that will help them in future career opportunities.

Minimum wages can also lead employers to alter other *non-wage aspects* of the job to compensate for the higher cost of minimum wages. Examples include reductions in free or subsidized meals, or break times or flexible hours or the provision of uniforms.

Minimum wages can encourage youth to *drop out of school* to seek the higher paying minimum wage jobs. Such dropping out can inhibit the acquisition of education and credentials that otherwise yield a very high monetary rate of return especially in the growing knowledge economy.[9] Dropping out may be a particularly myopic act on the part of youths as

5 Those who illegally were working at wages below the old minimum wage are not likely to be affected, or affected much, because if they were working illegally under the old minimum wage they are likely to continue working illegally under the new minimum wage.

6 The literature on the impact of minimum wages focuses on the employment impact and not on the underlying mechanisms whereby it occurs. The possible adjustments cited here have been prominent in lower-wage labour markets, albeit the extent to which they can be attributed to minimum wage increases is an open question.

7 Canadian evidence on scarring effects for youths is provided in Oreopoulos, von Wachter and Heisz (2012) who also discuss the international evidence.

8 Battle (2003) indicates that more than half of all minimum wage workers in Canada had been in their current job for less than one year, and only about 1% of persons had been in their job for more than five years. US evidence that most minimum wage jobs are temporary stepping-stones is given, for example, in Carrington and Fallick (2001), Long (1999), Schiller (1994) and Smith and Vavrichek (1992).

9 Gunderson and Oreopoulos (2010) summarize the evidence indicating that the monetary real returns to an additional year of education are in the neighbourhood of 10%, slightly higher for females and slightly lower for males. Returns are especially high for completing key phases as opposed to dropping out, and they are especially high for otherwise disadvantaged groups who complete their education as opposed to dropping out, and these are likely to be youths who would otherwise drop out to seek the higher paying minimum wage jobs.

Minimum wages can also reduce the training opportunities for workers to the extent that workers were willing to work in lower wage jobs that provided training or experience that would enhance their subsequent earnings.

evidenced by the fact that they often subsequently express regret over that decision.[10] Again, this potentially negative effect of minimum wages in encouraging dropping out of school is subtle, less visible and occurs in the longer run.

Minimum wages can also increase prices to the extent that the cost increase can be passed on to consumers in the form of price increases. In today's environment of global competition this adjustment mechanism is likely to be limited. However, it can occur to a degree for goods that tend to be consumed by the poor since minimum wage workers tend to work in industries like food services, agriculture and wholesale and retail trade.

Are There Possibly Offsetting Factors that Could Mitigate any Adverse Effects?

There are a number of potentially offsetting factors that could mitigate the potential adverse effects of minimum wages. These adjustments, however, often have other negative consequences or they are ones that could occur voluntarily without a minimum wage increase.

Employers may be *"shocked"* into using more efficient managerial practices that do not involve employment reductions to offset the cost increase from minimum wage increases. Some of these adjustments, like reduced break times or meal allowances, however, obviously have negative ramifications for minimum wage workers. Even if they do not, this begs the question as to why a minimum wage increase was necessary to spawn such actions. If they are efficient practices they should be done even without any minimum wage increase.

Employees may also be *"shocked"* into more efficient practices in response to a minimum wage increase. Productivity may increase if they feel more loyal and committed to their employer, and turnover and absenteeism may be reduced. To that extent, minimum wage increases may "pay for themselves." If such "efficiency wage" offsets prevail, however, employers should voluntarily follow them without the inducement of minimum wage increases. Relying on minimum wage increases to induce such positive responses on the part of employers or employees rests on the hazardous assumption that governments know better than employers as to how to run their business, and that employers need government inducements to prompt them into actions that is in their best interest.

It is possible that higher legislative wages may *reduce the incentive to join unions* on the part of low-wage workers, and unions could involve even higher cost to employers than minimum wage increases. Whether receiving a higher wage to stave off being a union member is in the best interest of workers is an open question. As well, if it was in the interest of employers to pay higher wages to avoid the threat of a union they should have the incentive to do so voluntarily.

10 Canadian evidence of such regret with dropping out is given in Price Waterhouse (1990, p. 14) based on focus groups, and Bowlby and McMullen, 2002, p. 16) based on survey evidence.

The adverse employment effect could also be potentially offset for employers who are reluctant to increase their wages to attract new recruits if they would have to pay those higher wages to their existing incumbent workforce for reasons of internal equity. If minimum wage legislation forces them to pay that higher wage for new workers as well as their existing low-wage workers they are no longer inhibited from hiring the additional workers. The cost of expanding their workforce is the higher minimum wage they have to pay; it no longer includes the additional wage they have to pay their existing workforce to match the wage they have to pay for new recruits. This situation, termed *monopsony* by economists (Card and Krueger 1995; Manning 2003) could lead to no adverse employment effect and even the possibility of an employment increase over a range of small wage increases. Whether this is more of a theoretical curiosity or a real world possibility is an open question.

Arguments have been made that minimum wages could put purchasing power in the hands of low-wage workers and hence *increase aggregate demand* that would increase employment. This is not likely to be prominent since it would require large numbers to be affected in a substantial fashion. As well, any aggregate demand effect from those who retain their job could be offset by the reduced purchasing power of those who lose their job or have their hours of work reduced or who have to pay higher prices because of the minimum wage increase. Also, it may be offset by employers who absorb the cost increase by reduced spending in areas such as investment.

Clearly there are a variety of potentially offsetting factors that could at least mitigate some of the otherwise potential adverse consequences of minimum wages. In many cases, however, they carry other adverse consequences for workers. In other cases, they are ones that employers would have an incentive to apply even without the prompting from government induced minimum wage increases.

Arguments have been made that minimum wages could put purchasing power in the hands of low-wage workers.

What is the Evidence on the *Actual* Effects?

The previous discussion highlighted the *potential* negative effects of minimum wages as well as possible factors that could offset these effects. As such, the effect of minimum wages is ultimately an empirical proposition. Unfortunately, the empirical evidence is often inconclusive, although there is more agreement on some aspects than others.

With respect to the key *employment effects*, prior to the 1990s there was a "consensus" based on US evidence that a 10 percent increase in the minimum wage would lead to a 1 to 3 percent reduction in the employment of teens.[11] During the 1990s and subsequently, however, a number of studies found no adverse employment effect,[12] while some found effects that were within the former consensus range[13] and others found even larger negative effects in the neighbourhood of a 6 percent reduction in employment resulting from a 10 percent increase in the minimum wage.[14] As such, the US evidence suggests that a 10 increase in the minimum wage would lead to a reduction in employment in the range of 0 to 6 percent with continued controversy within that range.

In spite of the large number of US studies on minimum wages there has been no clear reconciliation of the reasons for the variation in the results or why they may have changed over time. The studies often involve different data sets and different methodologies and many that find no adverse employment effect focus only on short-run adjustments and do not capture the more subtle possible long-run adjustments. However, there is remarkably little analysis of the extent to which these or other factors may account for the different results. As well, as pointed out by Neumark (2001, p. 128) and Hamermesh (2002, p. 716), the evidence in the US may be fragile because there is little variation in minimum wages in the US from which to identify their impacts since minimum wages in the US are under federal jurisdiction with changes seldom occurring and being uniform across the country. Variation in minimum wages in the US tends to come from variation

11 Based on approximately 26 studies reviewed in Brown, Gilroy and Kohen (1982), 28 in Brown (1999) and 29 in Card and Krueger (1995, p. 180-82).

12 US studies finding no adverse employment effect include Card (1992), Card, Katz and Krueger (1994), Card and Krueger (1995), Mills, Roy and Williams (1999) and Zavodny (2000) and in more recent studies by Allegretto, Dube and Reich (2011) and Dube, Lester and Reich (2010).

13 US studies finding adverse effects within the former consensus range include Neumark and Wascher (1992, 1994), Williams (1993) and Williams and Mills (1998).

14 US studies finding adverse employment effects larger than the former consensus range include Burkhauser, Couch and Wittenburg (2000), Deere, Murphy and Welch (1995) and Kim and Taylor (1995).

in coverage, or the slow decline of the real value of the minimum wage as its infrequent changes do not keep up with changes in the average wage of the state, or because of variation in state 'top-ups' which have been more prominent in recent years. This is in contrast to Canada where minimum wages are under provincial jurisdiction and there has been considerable variation in minimum wages both over time and across jurisdictions from which to identify their impact.

Perhaps because of this better data from which to estimate its impact, the Canadian evidence is more in agreement, with the recent evidence based on different data sets and methodologies generally finding that a 10 percent increase in the minimum wage reduces employment by about 3 to 6 percent for teens and slightly less for young adults.[15] Some evidence also indicates that the adverse employment effect tends to fall on more disadvantaged workers who have more permanently been working in low-wage jobs. The effect is negligible for workers who are more advantaged in that they are only temporarily working in minimum wage jobs (Campolieti, Gunderson and Lee 2014).

British evidence documents an adverse employment effect in the *low-wage home-care sector* whereby a 10 percent increase in the minimum wage would reduce employment by about 1 to 3 percent (Machin & Wilson 2004). For the economy as a whole no adverse employment effect tends to be found (Stewart 2004); however, that evidence tends to capture only short-run effects. The increases were announced well in advance so that some adjustments may have occurred prior to the increase, and the increases were very small and consciously instituted at a time when they could easily be absorbed by an expanding economy.

International evidence for nine OECD countries tends to find that a 10 percent increase in the minimum wage would reduce teen employment by approximately 3 to 6 percent, as is the case with Canada. Spain and Portugal are excluded from that analysis because of data limitations; if they are included in spite of the data problems, the adverse employment effect drops to approximately 0 to 2 percent (OECD 1998).

What can be concluded from such a mixture of evidence? Based on the Canadian evidence, a reasonable interpretation is that a 10 percent increase in the minimum wage would lead to a 3 to 6 percent reduction in the employment of teens. This is substantiated by a number of recent US studies and European studies when high quality data is used. It is the case, however, that there is considerable controversy in this area, with credible US studies finding adverse employment in the former consensus range of 1 to 3 percent as well as no adverse employment effect.

With respect to effects on *hours of work*, there is much less evidence. The limited evidence suggests that minimum wage increases lead to a slight reduction in hours of work or no effect.[16] To the extent that there is any reduction in hours worked, this would be added to any adverse employment effect with the total effect being a reduction in hours of work as well as employment.

With respect to *training*, the evidence from the US suggests that minimum wages reduce training, albeit the effects are often small and statistically insignificant.[17] The only Canadian study (Baker 2005) generally finds a negative effect on training largely because of the reduced on-the-job training associated with the adverse employment effect, but the results are not robust.

With respect to *education*, most studies tend to find that higher minimum wages encourage students to leave school to try to obtain the higher-wage minimum wage jobs, but the evidence is somewhat mixed.[18] The only Canadian study in this area finds no effect on enrolment (Campolieti, Fang and Gunderson 2005b).

With respect to the effect on *prices*, there is limited evidence and it tends to suggest that minimum wages lead to slight price increases, especially for goods and services consumed by the poor.[19]

15 The recent Canadian studies include Baker (2005), Baker, Benjamin, and Stanger (1999), Campolieti, Fang, and Gunderson (2005a, 2005b), Campolieti, Gunderson, and Riddell (2006) and Sen et al., (2011).

16 A slight reduction in hours of work is found in Gramlich (1976) and Brown, Gilroy and Kohen (1983), with no effect found in Zavodny (2000). In their discussion of the literature, Sabia and Burkhauser (2010, p. 598) conclude: "existing estimates in the literature tend to point to either no effects or only small negative effects" on hours worked.

17 Negative effects of minimum wages on training for the US are found in Grossberg and Sicilican (1999), Hashimoto (1982), Leighton and Mincer (1981) and Neumark and Wascher (2001), although Acemoglu and Pischke (2001) find no effect. For the UK, Arulampalam, Booth and Bryan (2004) also find no effect.

18 US evidence on the negative effects of minimum wages on education is found in Neumark and Wascher (1995a, 1995b, 1996) and for some race-sex groups in Cunningham (1981) and for teens in low-income families in Ehrenberg and Marcus (1980, 1982) although in that study that minimum wages increased the education for white teenagers from high-income families. Card (1992), however, finds no effect on enrolment and Mattila (1981) finds positive effects.

19 Evidence that minimum wage increases lead to price increases is given in Card and Kruger (1995), MaCurdy and McIntyre (2001) and Wessels (1980) but not in Katz and Krueger (1992).

The Canadian evidence is more in agreement that minimum wages have no effect on reducing poverty and may even exacerbate poverty slightly.

With respect to the important aspect of the impact of minimum wages on *poverty*, the existing US literature tends to find that minimum wages have no statistically significant effect on reducing poverty, although a few find that they exacerbate poverty and a few find that they reduce poverty.[20] The lack of a clear relationship reflects the poor targeting of minimum wages towards the poor since many poor persons do not work and those that do work tend to have wages above the minimum wage or other family members with wages above the minimum. Minimum wage increases tend to go to workers in non-poor households especially with multiple-earner families. When poverty is increased because of minimum wages it tends to be because of the adverse effect on employment and hours of work. Minimum wages can certainly move some people out of poverty because of their higher wage, but this tends to be offset or more than offset by the fact that they also move some people into poverty because of their adverse effects on employment and hours worked.

The Canadian evidence is more in agreement that minimum wages have no effect on reducing poverty and may even exacerbate poverty slightly.[21]

Neither the Canadian nor US studies include any longer run effects on increasing poverty that can occur through various mechanisms: reduced training or education; longer run scarring effects if minimum wages make it more difficult for youths to obtain initial employment; or higher prices for goods consumed by the poor.

20 The US literature on the effect of minimum wages on poverty is summarized in Neumark and Wascher (2008, Chapter 5) and Burkhauser and Sabia (2007) who conclude no effect or a small effect in increasing poverty. A recent study by Dube (2013) however finds evidence of minimum wages reducing poverty.

21 The Canadian studies finding no impact on reducing poverty include Benjamin (2001), Shannon and Beach (1995), Mascalla et al. (2009) and Campolieti, Gunderson and Lee (2013). Sen et al. (2011) find that minimum wages increase poverty.

Are There Better Alternatives?

While there remains legitimate controversy around the impact of minimum wages, both basic economic theory and a substantial amount of empirical evidence suggests that minimum wages have negative effects in various dimensions: reduced employment and hours of work; reduced training and education; possible longer-run scarring effects if initial job opportunities for youths are reduced; higher prices for goods and services consumed by the poor; and no effect on reducing poverty and perhaps even a negative effect by increasing poverty. The Canadian evidence in particular is in substantial agreement on the key issues of reduced employment opportunities and no effect on poverty or perhaps even exacerbating poverty.

These issues are especially important given the growing attention that is being paid to youth unemployment and the problems that youths (and especially school dropouts) are having in obtaining employment. Since they are disproportionately impacted by minimum wages, it would seem that even a low-wage job would be preferred to no job with its potential longer-run scarring effect.

Minimum wages also have the unattractive feature that the costs are typically born by a small subset of small employers in accommodation and food services, agriculture, and wholesale and retail trade. If society in general deems that individuals should not have to work at jobs that pay below a certain minimum even if their productivity is below that minimum, then it would seem appropriate that society in general bear that burden rather than imposing it on a small subset of employers. And there are policies whereby society in general can assist the working poor.

Training programs including apprenticeships targeted towards youth can enhance their productivity which would increase *both* their wage *and* employment, in contrast to minimum wages which risk reducing employment by *artificially* raising their wage. The same applies to reducing dropouts from high school so that they can reap the benefits of the high returns to education and especially for completing key phases of education. These issues can be particularly important for Aboriginal youth where dropout rates are high.

The cost of increasing low wages for the working poor can also be distributed more evenly across society through programs such as the Earned Income Tax Credit (EITC) in the US[22] or its equivalent of the Working Income Tax Benefit (WITB) in Canada. Such policies basically involve a government subsidy (through the tax system) to enhance the wages of the working poor rather than mandating that the cost be borne by a small subset of employers through having to pay higher minimum wages. The fact that the cost of the higher wages do not fall on employers means that they do not have an incentive to reduce employment or hours, and the higher wages for workers gives them an incentive to work. The fact that it is administered through the tax system means that the subsidy can be based on family need and it can be reduced as income increases so as to minimize spillover benefits to persons with higher income. As well, the cost is borne by society in general rather than a small subset of employers. In essence, such earnings subsidies are much better targeted to the working poor, without benefits spilling over substantially to the non-poor, and without adverse employment effects.

In essence, minimum wage policies highlight the economic "law of unintended consequences." Well-intended policies with populist and political appeal can harm the very persons they are intended to help. Furthermore, alternative policies can achieve the desired ends without the harmful unintended consequences.

This is not meant to imply that minimum wage laws should be repealed or even that they be frozen at current levels. Rather, the following policy recommendations flow from this analysis:

- First, place more emphasis on the adverse employment effects, which are likely to be present in Canada. Currently, the discussion tends to focus on wage gains which is only half of the story – and only the half that is positive. The adverse employment effects are particularly problematic since they disproportionately fall on youths who are already at risk of not obtaining jobs and who may experience a long-run scarring effect if they don't obtain jobs when they enter the labour market.
- Second, minimum wage increases should be implemented at times when the economy is expanding and can absorb the cost increases with minimal reductions in employment. In that vein, it is best *not* to pre-commit in advance to increases that would occur independent of the state of the economy, or that are *automatically* tied to aggregate indicators like inflation or the average wage rate.
- Third, minimize the adjustment consequences by implementing more continuous small increases rather than occasional large increases of the same ultimate magnitude.
- Fourth, political appeal notwithstanding, do not regard minimum wage increases as a panacea for curbing poverty. They are at best an exceedingly blunt instrument and may even be harmful in that regard. The potential harm comes from the adverse effect on employment and possibly on training and schooling. As well, it may give the appearance that something is being done in that area and this can detract from using other more effective instruments for curbing poverty. This is especially the case since minimum wage legislation deals with the *symptom* of low wages (which has political appeal) and not *underlying causes* such as low education, training or experience as well as possible discrimination.
- Consistent with evidence-based policy making and the negative effects outlined previously, make the minimum wage increases modest, where "modest" would be determined by the economic conditions of the time and especially the state of the youth labour market. As the expression goes: "As long as the floor is not raised too much, the roof is not likely to fall in."

22 The EITC as an alternative to minimum wages is emphasized, for example, in Burkhauser, Couch and Glenn, (1996), Burkhauser and Sabia (2007) and Sabia and Burkhauser (2008, 2010).

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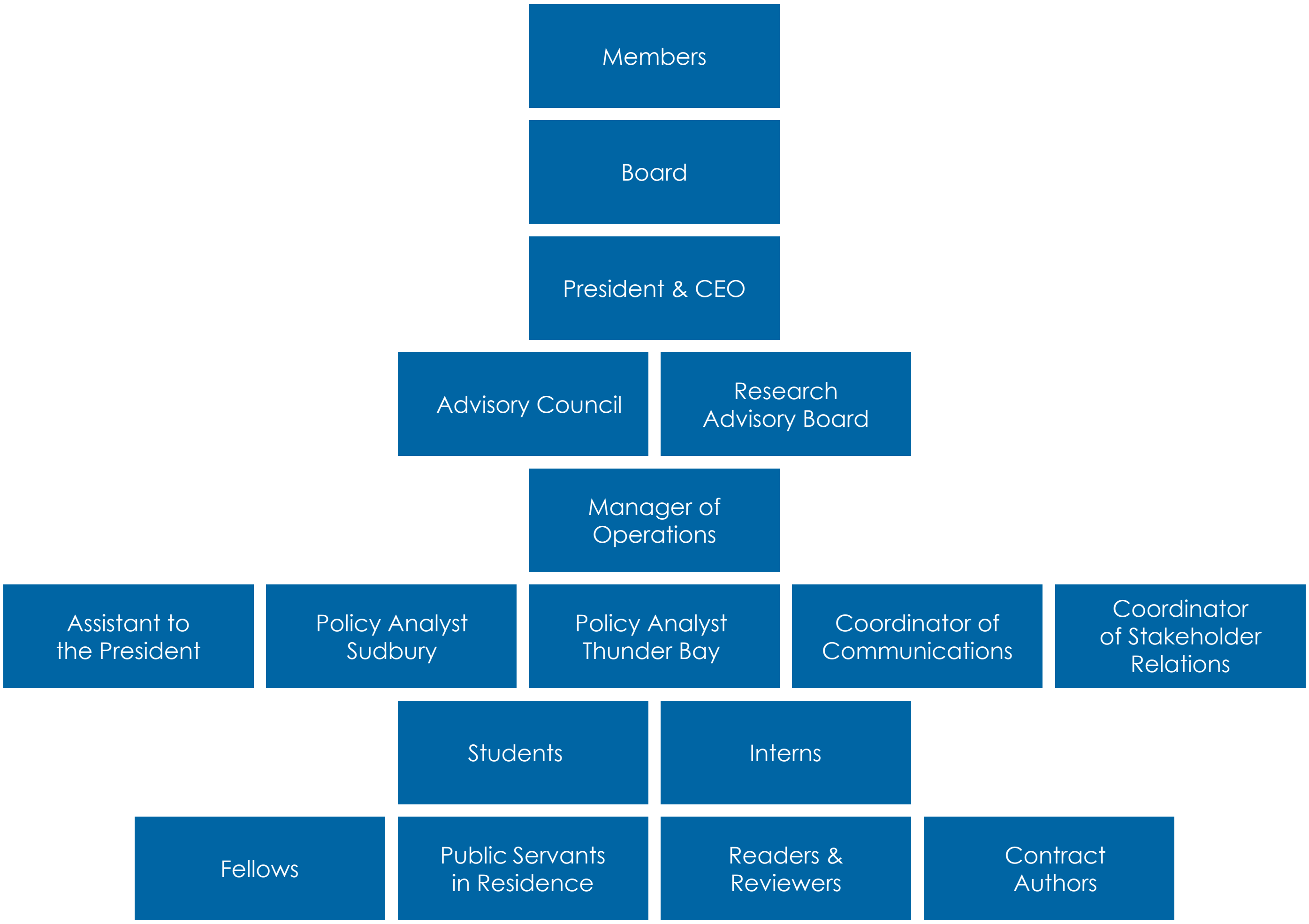

Some of the key players in this model, and their roles, are as follows:

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CEO: Recommends strategic direction, develops plans and processes, and secures and allocates resources to achieve it.

Advisory Council: A group of committed individuals interested in supporting, but not directing, the work of Northern Policy Institute. Leaders in their fields, they provide guidance and input on strategic direction, communication, potential researchers or points of contact in the wider community. They are Northern Policy Institute's source of "sober second thought" on overall organizational direction and tactics.

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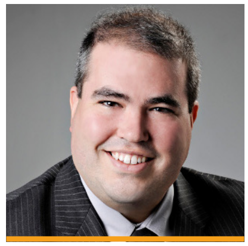
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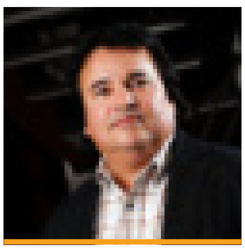
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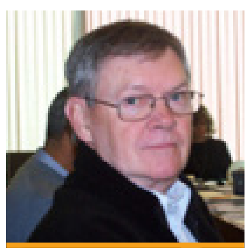
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