

Opinion | Better ways to help workers than minimum-wage hikes

Vivek Moorthy Thursday, 20 October 2021

“Easier zoning laws to raise rental housing supply are needed for a living wage in America”

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This year’s Nobel prize for Economics was awarded to David Card, Joshua Angrist and Guido Imbens for their natural experiments on a range of labour market issues. Card and Krueger’s startling conclusions about the impact of a rise in the minimum wage, comparing fast-food joints in New Jersey, where the state minimum wage was hiked from \$4.25 to \$5.05 in 1992, with a control group in adjoining Eastern Pennsylvania, where it was not hiked, has received wide attention since then.

Standard free-market economics based on the perfectly competitive firm predicts that employment will fall. In their trail-blazing 1994 paper, Card and his late colleague Krueger claimed to find the opposite: employment actually rose in New Jersey relative to Eastern Pennsylvania. In its award statement, the Nobel Committee discussed this paper at length, and plotted a chart depicting their findings.

Minimum-wage policy is not just nitpicking on some arcane academic matter. The economic impact of raising the minimum wage was a major issue in America’s Trump-Biden-Harris presidential debates. In recent years, urban America, and California in particular, have been ravaged by homelessness, and many working poor are undoubtedly struggling. Strong political and social compulsions have raised the wage floor in California to \$14 per hour, as of 2021, with \$13 for establishments with 25 or less workers.

The federal minimum wage, the binding floor for all states’ minimum wages in the US, is at present \$7.25 per hour. It has not been changed since 2009. As of 2021, the binding minimum wage for 17 states in America is the federal one. Pressures to raise the minimum wage in many states are clearly mounting, although Republican-controlled states where the Federal minimum wage is binding may resist. This year, 21 states raised their minimum wage from the 2020 level to an average of \$11.33 per hour.

The granting of a Nobel prize to David Card lends even more intellectual respectability to the widespread \$15-an-hour minimum living wage campaign in America now. Former US President Barack Obama had appointed Alan Krueger as a top policy advisor and wanted to raise the federal minimum.

Let us take for granted the Card-Krueger conclusion that minimum wage increases do not reduce employment. However, note that this conclusion is dubious, as a rejoinder by David Neumark and William Wascher to the original Card-Krueger 1994 paper and their critiques of subsequent similar papers have pointed out. The Nobel statement doesn't mention the Neumark-Wascher critiques. Surprisingly, ditto for the commentary on the award that I have read so far—which is admittedly quite limited.

It is certainly the case that small increases in the minimum wage over time can be absorbed by an economy without adverse effects. This is due to rising productivity, which leads to sustainable higher average real wages. Indeed, minimum-wage hikes can act as a spur to devising labour-saving machinery.

Nevertheless, it does not follow that minimum wages should be the main thrust of policy to help America's working poor. A wage of \$ 14 per hour at the market exchange rate is a princely amount in most parts of the world. If people are struggling to make ends meet at that wage in San Francisco and Los Angeles, going by the staggering rise in the number of homeless there, one must first ask why the cost of living, and of housing in particular, is so high in America. As per recent data, the average monthly rental for an apartment in California was \$1,731 (Statista.com). Let us take \$1,600 as the rental for a very low-end flat in very expensive San Francisco. At close to the minimum wage of \$14 for a 40-hour week (which all workers wanting to work 40 hours a week may not get), a full-time worker staying alone earns, say, \$2,200. Rent is then over 70% of monthly income. It is hard to manage on that, and impossible to do so unless the worker gets to work 40 hours a week.

There are many reasons in general for the high cost of living in America, ranging from exorbitant medical expenses to its excessive litigation, especially over medical malpractice, and others. However, the main reason, in my opinion, is the strict zoning laws of America that prevent the setting up of commercial dormitories catering to the poor, students, single individuals and many others in similar categories.

Allowing 'granny apartment' annexes on the same plot, flexible sub-leasing arrangements, short term rentals, quicker evictions for defaulting on rent and the conversion of unused garages into rented rooms will all increase the rental supply and bring down rents. Airbnb by itself cannot do the job. The number of persons per dwelling unit in the US has been falling from the 1950s onwards, when the norm was a male bread-earner as tenant with dependent wife and kids. The US zoning laws are suited for its suburbia.

In short, current proposals to hike the minimum wage in America are misguided because these hikes will barely help meet housing rental costs. The perennial debates on the country's minimum wage detract attention from far more crucial policies needed to reduce the cost of renting homes for the working poor.

As for the limitations of natural experiments and randomized controlled trials, and the drawbacks of basing social and economic policy upon them, I shall discuss them in a follow-up article.

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