Of minimum wages and other vices of the labour market…

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The outcome of yesterday's first day of social dialogue regarding the future of the minimum wage in Greece is important for two reasons: first, because the social partners vowed their support to the 13th and 14th salary and agreed any pay decreases (or wage freezes – practically it's the same any way) to be implemented from 2013 onwards (with the signing of the new national collective agreement); and, second, because their stance provides a firm answer to the government's 'threat' that it will legislate a reduction to the minimum wage if the social partners' agreement is not deemed viable.

Faced with these developments, one cannot help but wonder about the actual necessity of a decrease in the minimum wage – be it through a cut or adjustment of the 13th and 14th salaries, or through a wage-freeze clause, or any other formula one may imagine. When the government initiated the above discussion about two weeks ago, and urged the social partners to agree on a common solution, its argument run as follows: the existence, and especially the level, of the minimum wage create frictions in the labour market, resulting to the sub-optimum allocation of resources and to the inability of many firms to cope with the existent labour cost. Consequently, they either shut down or sack people, increasing therefore unemployment. Moreover, the level of the minimum wage creates a non-competitive environment, as future investors are refrained from entering the Greek market due to the aforementioned friction. Therefore, a reduction of the minimum wage (or, why not?, its complete abrogation) will reverse, or at least slow down, this situation. Indeed, modern labour economics textbooks provide ample theoretical justification of the above thesis. The basis of the argument is the classical individualistic thesis of the neo-classical school, i.e. the fact that if markets are allowed to operate without frictions they will eventually 'clear' at an optimum level of wage and employment.

Interestingly enough, if one accepts the above argument one is also bound to question the *raison d' être* of many other 'frictions' that labour markets in advanced capitalist economies exhibit. For instance, following the exact same logic, one may regard all employee-friendly labour legislation as a huge friction in the 'free' function of the labour market. Why, for example, should the five working-day week exist? Isn't a day of rest enough for the employee to rejuvenate herself before going back to work? Or, why do we need the (legislated) 40 hours week? Why should maternity leaves (or paid annual leaves in general) exist? Wouldn't it be much cheaper if the employer just sacked the pregnant woman and hired another person in her place? In terms of aggregate unemployment, at least, nothing would change. Or, to take the argument even further, why shouldn't child labour be legal? Children at the age of 6 or older can easily be occupied in various jobs, increasing that way the GDP, and offering a financial breath to their struggling families. Anyway, many of the cheap products that the Western society consumes are fabricated under shabby working conditions by children in factories or sweat-shops in the developing world – a look at the International Labor Organisation's or the International Trade Union Confederation's annual reports is quite apocalyptic. Since we mentioned working conditions, imagine how much an employer could save if he was allowed to refrain from implementing such anachronistic regulations as the Health and Safety Acts. Anyhow, the current level of unemployment makes it much cheaper for a company to replace an employee than applying these rules. Last, but by no means least, one should also consider the most important friction of all in the labour market (and the source of all vices): the trade unions. Is it really necessary for such monopolistic practices to exist in the labour market, in today's world of enlightened management?

Although current economic literature may dismiss the arguments on firing pregnant women (or any other employee) by reference to human capital theory – it may be more expensive to re-train new workers, or to lose the cumulative knowledge employees bring with them in the enterprise – or make a case against child labour by arguing that the exploitation of children may have detrimental effects on the long run, as today's children are tomorrow's (tired and destroyed) adult workforce[1], it does not necessarily free the neo-classical logic from its individualistic perspective. To do so, one may need to make a different kind of argument, based on an alternative ethical basis, or to take into consideration the impact of various societal factors. But in this way one would immediately place oneself outside the logic of the neoclassical paradigm; or would one?

Even though economic modelling seems 'objective', it nevertheless reflects its historical era. The fact, for instance, that the Greek society will not (hopefully!) tolerate legitimising child labour as a means of getting us out of the crisis, shows that it has reached a level of maturity which renders any such discussion irrational. This holds for any advanced capitalist society, something that inevitably also informs its science. The fact that modern labour economists do not advocate the reduction or the elimination of annual paid leaves, of health and safety regulations etc, does not necessarily have to do with the logic of their science but with the adaptation of this logic to the social context in which it is expressed. History has shown that the ceiling of any policy is the floor of each epoch's social tolerance – and nowhere is this truer than in the case of economic theory and practice.

Yet if one admits that social considerations influence the logic of the orthodox economic paradigm, one may start using them as justification *against* certain economic policies. Why, for instance, is it legitimate to discuss the reduction of the minimum wage and not the abolition of maternity leave? An (economic) answer to this question could be that any losses from the reduction of the minimum wage will be counterbalanced by the potential benefits. Thus, a good economist would calculate the positive and the negative consequences of such a policy and, based on this calculation, would decide whether the costs outweigh the benefits and vice versa before proceeding (interestingly enough, the dismissal of child labour by contemporary orthodox economics is also based on a similar calculation[2]). This kind of behaviour, however, takes us deep into the argument's empirics.

Let us momentarily assume that the neoclassical thesis is theoretically logical and ethically substantiated; does it have a strong empirical grounding? Unfortunately not; for as various researches, both from the orthodox and heterodox camps, have demonstrated, the link between minimum wage and growth or unemployment does not necessarily run to the direction the theory has it. Since the seminal work of David Card and Alan Krueger[3], various researches have demonstrated that the reduction (or the abolition) of the minimum wage does not deterministically reduce unemployment or improves competitiveness; on the contrary, it may also harm them. The same literature also warns about the consequences such a move may have on growth, on the productivity of labour, on income distribution (especially on the more susceptible participants in the labour market – young workers and women), on poverty, on consumption, on industrial peace etc[4]. Moreover, the social policy literature reveals the consequences the above have on important social issues such as criminality, family relations, gender relations and gender equality, and so on and so forth.

Having all these in mind, one would expect that the proposed policy would be thoroughly studied and its consequences properly evaluated. Yet, as with almost every institutional change that has taken, or was about to take, place in Greece since the signing of the Memorandum (see, for example, the deregulation of the Taxi drivers profession[5]), in this case as well no prior evaluation of the measure's possible results was ever conducted – at least, I am not aware of any *published scientific study* on the matter. I sense that the (potential) positive consequences of this attempt will never balance the negative ones. Anyhow, for the past couple of years the government implements various decentralisation policies to no effect on unemployment – on the contrary, the latter is soaring by the day. What makes us think that the reduction of the minimum wage will necessarily halt this route, or will boost investment overnight?

In the final analysis, one wonders whether the problem with Greece is quantitative or qualitative. Are wages responsible for the economy's low competitiveness or low investments, or is it the conservative nature of the Greek capital and banking system, or the State's cronyism? Wouldn't a more rational use of the country's human capital lead to better labour productivity? For we must not forget what the Americans say so blatantly: "when you pay peanuts, you get monkeys". I am very much afraid that the low road policies currently adopted in Greece will eventually lead us exactly there; in the heart of the jungle.

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[1] For an exposition of this argument see Chang, H.-J. (2010). “Institutions and Economic Development: Theory, Policy and History.” Journal of Institutional Economics **7**(4): 473-498.

[2] See, for example, Basu, K. and P. H. Van (1998). “The Economics of Child Labor.” The American Economic Review **88**(3): 412-427, Baland, J. M. and J. A. Robinson (2000). “Is Child Labor Inefficient?” Journal of Political Economy **108**(4): 663-679.

[3] Card, D. E. and A. B. Krueger (1995). Myth and measurement : the new economics of the minimum wage. Princeton, N.J, Princeton University Press.

[4] See, among others, Manning, A. (2003). Monopsony in motion : imperfect competition in labor markets. Princeton, N.J., Oxford, Princeton University Press, McLaughlin, C. (2009). “The Productivity-Enhancing Impacts of the Minimum Wage: Lessons from Denmark and New Zealand.” British Journal of Industrial Relations **47**(2): 327-348, Fanti, L. and L. Gori (2010). “Economic Growth and Welfare in a Neoclassical Overlapping Generations Growth Model with Minimum Wages and Consumption Taxes.” LABOUR: Review of Labour Economics & Industrial Relations **24**(3): 238-262, Kaufman, B. E. (2010). “Institutional Economics and the Minimum Wage: Broadening the Theoretical and Policy Debate.” Industrial & Labor Relations Review **63**(3): 427-453, Fanti, L. and L. Gori (2011). “On economic growth and minimum wages.” Journal of Economics **103**(1): 59-82.

[5] http://blogs.lse.ac.uk/greeceatlse/2011/07/07/i-had-a-dream-about-taxi-licensing/