Coupled with firm subsidies, a minimum wage is not that bad.

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Minimum wage

- Among non economists or non mainstream economists, minimum wage is viewed as a tool to achieve a more fair distribution of earnings and incomes than in the laissez-faire

- Among mainstream economists, minimum wage is viewed as the archetypal bad redistributive instrument

- Basic income or negative income tax are viewed as far better instruments
Outline

1. Comparison basic income and minimum wage
   - It is thought that the first is far better than the second.
   - We revisit the argument and we argue that it is quite the contrary if we add to basic income another instrument, a wage subsidy to firms.
   - A wage subsidy to firms is far better than a wage subsidy to workers and let the wage adjust

2. A reform proposal for France

Warning: We do not discuss about people outside the jobmarket, people who do not work
1. Theoretical Analysis
Two competing ideas about working poor

• Society should guaranty a decent well-being whatever people work or not
  – Laisser-faire coupled with benefit to working poor

• People should sustain with their work
  – Minimum wage
  – Use of market price as a tool for income maintenance
  – The economists dismiss the idea because it introduces distortions
The standard argument

- The opinion against minimum wage fails to recognize the separability property between
  - an allocative purpose efficiently done by the markets (under assumptions)
  - a distribution purpose reached through a redistribution of property rights
- Basically, it is the 2\textsuperscript{nd} fundamental theorem of welfare economics.
- Big \textbf{if}: optimal lump sum transfers can be implemented.
Are economists right?

• Lump sum transfers are difficult to manage

• Optimal lump sum transfers cannot be implemented (Mirrlees “the curse of talented people”)

• Instead introducing distortionary taxes

• The welfare cost to introduce these tax wedges in order to sustain a basic income >\(< the welfare cost of the minimum wage.

• To compute the latter, we may (?) have to take into account the discontent from not receiving a decent wage from working
Revisiting the argument

• Suppose that we couple the minimum wage with a firm subsidy (a solution experimented at a large scale in France), the two solutions are not that far.

• We can always increase the firm subsidy up to the point where the labour cost is no more than the equilibrium wage.

• If so, then the two solutions appear quite symmetric
  – The firms pay no more than the equilibrium wage
  – The workers have both the same disposable income
  – The only difference is that we subsidy firms instead of subsidizing workers
Symmetric but not all that good

• We prove (graphically but it can be proved in a formal model) in the following that maybe contrary to the intuition, the minimum wage coupled with firm subsidy is a better second best instrument.
  – It is less costly for the Gvt (if the same tax mix is used to finance both schemes, same marginal cost of public funds)
  – The aggregated welfare change is higher. Always positive with minimum wage coupled with firms subsidy

• The reason: the benefit of the firm subsidy will be entirely pass through firms because of the minimum wage
  – While some part of the worker subsidy will be passed through firms
  – Interest of using both instruments instead of only one
Proof: Systematic comparison

• Assume that there is a political agreement about the level of minimum wage = the level of basic income when working = m

• The statu quo is a situation with a given minimal income

• Two reforms

• 1. Maintain the level of the minimum wage to m and introduce a subsidy to firms up to the point where the net-of-subsidy wage (labour cost) = laissez-faire wage

• 2. Remove the minimal wage and subsidy to workers up to the point where the free market wage + the subsidy = m.
   – In this solution, the market wage is free to adapt

• Same tax instrument to finance both subsidies
A subsidy to neutralize the employment loss of the minimum wage
A subsidy to worker wage + subsidy = minimum wage
Worker subsidy (green) more costly than firm subsidy (orange)
Proof for welfare change

• Aggregated welfare change = change in consumer welfare + change in profit + change in tax revenues
  – Initial situation: situation with minimal wage.

• When no income effects: change in consumer welfare = change in Marshallian surplus (the same as compensating variation and equivalent variation)
Aggregated surplus change for firm subsidy = orange triangle > 0
Aggregated surplus change for worker subsidy = orange triangle – green triangle: Ambiguous sign
Conclusion of the theoretical part

• Minimum wage coupled with firm subsidy dominates unambiguously work subsidy
  – Less costly
  – It is always beneficial in terms of welfare change to perform a decrease in labour cost up to the point where the labour cost reaches its laisser-faire level
  – It is a Pareto improving reform, even if we do not take into account the psychological benefit to sustain a decent standard of living without being subsidizing.
  – For a similar argument developed in a more formal analysis, see theorem 2 in Lee and Saez (2012) JPubE. “Optimal minimum wage policy in competitive labor market”
2. Implication for France

• The theoretical analysis points out that the economic policy followed since 1993 to subsidy the labour cost around the SMIC is a second best optimal strategy.

• It is a better strategy than the alternative strategy to suppress the SMIC coupled with subsidizing worker.

• We should go further. The variation of the aggregated surplus is positive up to the point that the labour cost is not lower than the laissez-faire labour cost (providing that the marginal cost of public funds is close to 1).

• Difficult to go further by reducing the employer social security contributions (13% of SMIC brut).

• While the policy up to now has alleviated the labour cost above the wage slip, we propose to alleviate the labour cost below the wage slip.
Two difficulties

- The French laissez-faire labour cost for low qualifications is unknown
- What tax instrument to finance the firm subsidy?
- Two pragmatic propositions
Subsidy level: a pragmatic proposition

- = French minimum wage - the mean of English and German minimum wages

- No more involuntary unemployment than the Brits and the German accept

- SMIC brut = 9.61€

- UK: 7.2 £ = 10.2 € = 7,9€ in ppps (to boost productivity, professional training)

- Germany = 8.5€

- Subsidy = 1.41€ per hour (decrease of 13% of the labor cost)

- The subsidy will diminish (or eventually vanish) if the Brits and German will increase their minimum wage, while the French keeps the SMIC constant
Cost = € 5,7 Billion (first round)

• Excluding phasing out
• Cost on the actually employed + Cost on the new hired
• Static cost
  – Number of workers paid at the minimum wage in the private sector = 2 Millions (1/8 in the private sector)
  – 1683 hours
  – € 5 Billion
• 260,000 more jobs at SMIC
  – Additional cost = € 0.65 Billion
How to finance?

- The least distortive or even Pigouvian taxes

- A tax on urban land (square meter)
  - To limit the urban sprawl
  - Artificialization of soils (5% of France area): bad for storm water runoff (Source: Corine Land Cover)
  - Additional tax on wealth (private gardens) (the best wealth tax see Bono, Bonnet, Chapelle, Trannoy, and Wasmer forthcoming)

  - 27,500 Km² = 27.500 billion square meter.
  - A tax of € 0.2 per square meter.
  - A landowner of a property of 1,000 square meter will pay about € 200

- A increase in a carbon tax
Conclusion

• Reducing the labor cost whereas maintaining the minimum wage: Ok but up to what level?
  – Theoretical response
  – Pragmatic response taking advantage of the move of our two most important European partners

• We should finally know whether the higher level of unemployment in France wrt to Germany and the UK is really due to higher labor cost or to other factors

• Labor unions should not oppose the reform (we keep the minimum wage)

• In the present political context, we should not be shy in terms of labor market reforms
  – The main winners will be the young and people from the minorities (because of deficiencies in initial education and vocational training)

• What remains to be done
  – With phasing out, cost X 2 at least. Still manageable
  – General equilibrium effects to be computed