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THE MINIMUM WAGE: ETHICS AND PRODUCTIVITY

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ABSTRACT

The less- or unskilled worker has been the target of the minimum or living wage argument for over a century, and the idea of appropriate minimum rates is a current problem facing both domestic and global companies. For many, the issue of whether there should be a minimum wage in the United States is divisive. Arguments that it would cause job loss and other societal problems have not been supported. Neoclassical economic theory views workers as a means of production and competition as determining wages which are, in turn, aligned to productivity. The view of wage as a motivating force to improve productivity is discussed. The alternative view that wages are determined also by the needs of workers to subsist is also highlighted.

INTRODUCTION

The less- or unskilled worker has been the target of the minimum or living wage argument for over a century [1], and the idea of appropriate minimum rates is a current problem facing both domestic and global companies [2]. For many, the issue of whether there should be a minimum wage in the United States is divisive. Some argue that it will cause job loss and other societal problems [3]. Others suggest that a fundamental underpinning of society is the ability to see the dignity and worth of human labor [4].

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However, when closely examined, the debate is actually one of both ethics and productivity: What should workers be paid ethically and to achieve the best level of productivity of the good, service, and/or knowledge?

PRODUCTIVITY

In some areas, the argument over the minimum wage has been labeled as being between "socialists" or "liberals" and "capitalists" or "conservatives." However, it seems much deeper than just a discourse on pay, but more of an issue about achieving the most productivity in the most ethical way possible. Most of those involved in making business decisions likely believe they rely on utilitarianism. Mill discussed this type of ethics as the theory of the greatest good for the greatest number [5]. In reality, most businesses focus on profit as the primary outcome of their inputs and throughput processes, and they concern themselves with the dollar amount they achieve.

However, outcomes of business inputs and throughput processes are not profit; rather, outcomes are the goods, services, and knowledge that derive from workers and are of some value to another person or firm. This systems model [6] is depicted in Figure 1. The breakdowns of such firms as Enron, WorldCom, Tyco, and HealthSouth were not simply accounting failures, but also failures in the firms' organizational behaviors. They were the result of firms viewing profit as their outcome and focusing all their efforts and systems toward achieving profit rather than a good, service, and/or knowledge valued by others. As seen in Figure 1, there is no adequate feedback loop for profit to determine the inputs needed, which resulted in the ethical failures in prominent firms in the early 2000s.

So what does this have to do with the minimum wage? Our focus determines how we perceive the world and our ethical contributions to it. This is true for the decision makers of a firm. If profit is the sole goal of the business—its primary outcome—then paying workers the lowest amount possible can, perhaps, make some sort of logical sense. But if the primary outcome or goal of the firm is a quality product, then paying the lowest amount possible is logically counter-productive. From an ethical perspective, if the focus is profit, then you will do anything to achieve the profit. This often skews perspectives, resulting in the argument that market forces drive the cost of labor.

It has been generally accepted that employers can pay what they feel is necessary to attract the type of employee that they require and what the market will bear [7]. However, as Giddings wrote:

> . . . this action of competition may be imperfect in the particular case [of rewards for labor]. So far as it is imperfect, the wages system is ethically defective. . . . we are compelled to admit that profits may contain at any given time a sum in excess of the normal equitable reward of the services rendered by the employer—a sum which it will be the function of further competition to distribute with approximate equity [8, p. 369].

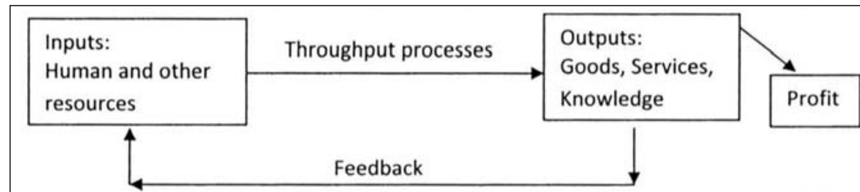

Figure 1. The systems theory of the firm.

He continues by explaining that the "sum" is profit. "Because the employer hopes that his product or service (or knowledge, in the new economy) will generate a higher price than expected, his profit would entail a sum entirely distinct from the reward of his industrial functions already provided for," e.g., expenses and cost of resources [8, p. 370]. In essence, the competitive process is defective because it does not create equitable distributions. Instead of considering wages to be a cost of production, Giddings suggests we consider them as a method of profit-sharing that corrects the defects in competition in the imperfect market [8]. In other words, profits should be shared with those who help create the wealth, in proportion to their services. Therefore, the issue of minimum wage is moot, as those creating the wealth would have an equitable and ethical distribution of that wealth.

When markets are efficient, wealth is increased by maximizing the firm's stock prices which, in turn, maximizes the firm's net present value [7, 9]. However, markets are not perfect, so profit actually occurs when firms take advantage of the negative external forces that make the market less than perfect. When this argument is carried further, economists argue that unlegislated morality creates a "tax," and moral firms will not do as well financially over time [10]. In fact, using this logic, Hardin shows that using economic competition to its inevitable logic results in destruction of the means of production in his famous cow herders example. In other words, "perfect market forms impose vice rather than virtue" [11, p. 3]. Usually, however, social values are connected with outcomes of the market—they do not exist in isolation from each other, as discussed by many scholars [12]. Market competition is dependent on social values, particularly trust. In addition, those values held most dearly will be an important part of market competition in the culture [13]. Approval or disapproval of those involved in the transactions or similar ones is a strong influence on behavior—a reputational good.

MINIMUM WAGE EFFECTIVENESS

If we use Giddings' argument in relation to those firms using the minimum wage to pay workers producing the outcomes of the firm, we can see how unethical the situation has become [8]. An example is Wal-Mart, the largest firm in

the world in terms of sales. Despite its profits, which obviously have been the primary focus of the firm, most Wal-Mart workers must use the national welfare system to supplement their incomes and to obtain health insurance not provided by the employer. The workers who help create the wealth have no equitable or ethical part of that wealth.

Often the debate has been structured as being between better wages for lower skilled workers on one hand, and job losses on the other [14], that is, as an either/or situation. However, most of the empirical evidence is not conclusive. Little, if any, disemployment effect has been found [15], even in cross-cultural studies. Some economists argue that the rigidity introduced by an enforced or negotiated minimum wage results in an excess supply of labor, reducing the number of jobs in the lower skilled worker groups [16], often called a "disemployment" effect [17].

However, minimum wages have not been found to cause unemployment. In fact, minimum wages have been found to have a positive effect on poverty levels and a positive effect on wages that are not in the sectors covered by the legislation [18]. In many countries, lower paid workers are concentrated in industries or parts of the economy where there is little job generation in any case, and, where jobs are available, the workers are neither paid well nor do they have much employment security [19]. In the United States, only a small percentage of workers are affected, so there are only small changes in the number of jobs lost [20]. Deltas found that, when considering only minimum wages that are publicly imposed, the minimum wage actually increases employment in the sector affected by the change [21]. Devereux [18] contends that a minimum wage can be an anti-poverty measure with little negative side effects when:

- employers are monopsonists, i.e., the market is not perfect;
- employees earn wages less than their marginal value product;
- the minimum wage level is not more than the marginal value product;
- there is a relatively inelastic demand for labor between current and projected minimum wage, preventing disemployment; and
- compliance can be monitored.

If we argue that the end product of any firm is wealth creation and that the purpose of hiring workers is to produce profit [22], there is still a production and ethics argument to be made that firms are under an obligation to pay their employees a part of the profits that the workers help create. This argument was initiated in the 1880s, but Filene stated it eloquently:

> If we should establish a minimum wage of $14 for out-of-town stores, we should have a chorus of protests. The reason is that the proprietors would look only at the $14 wage and would not see that it is better that they be forced to do a business that can afford to pay a $14 wage than just barely to scrape along as most of them are now doing. One of the ways for any one of the proprietors to lessen his chances of being forced out is to make his

> business more efficient. One of the ways of increasing efficiency is to pay wages that will command a high enough grade of employee to make it unnecessary for the proprietor to put in most of his time directing and correcting errors of inefficient, underpaid people [23, p. 411].

Filene also stated that the minimum wage is necessary because the lower boundary is set by greed, that is, by "the meanest and most short-sighted employers" [23, p. 411]. He also believed that competition forces wages down, because production capacity is higher than the amount of goods and services that any group of people could use.

MINIMUM WAGES AND PRODUCTIVITY

Where business spends its profits is an ethical decision. It is only ethical that the means of wealth creation, the workers, should share in the profit resulting from the outcomes of their work. Giddings proposed that the objections to sharing profit are not valid.

> It is not a valid objection to say that wages are a commutation of the workman's theoretic share of the industrial product, the sum deducted being the premium paid for the insurance of that share, the employer assuming all risks of loss. Wages paid in connection with profit-sharing are not a commutation. They are a partial payment of the workman's theoretic share, as the sums taken by the employer in the form of salary or otherwise for his current personal expenses are a partial payment of his theoretical share. Workman and employer both may receive, ultimately, the remainder of their theoretic shares, or they may find that they both have worked to some extent for nothing. But, if one loses, the other loses. Their risks are the same [8, p. 374].

The argument that "their risks are the same" may not hold true in today's global economy. In fact, it may be that the worker risks more than the employer. In the globalized economy, the employer chases the least expensive worker, product, service, and knowledge, regardless of the quality. Whether this will change remains to be seen. So the worker can lose without a risk to the employer, who has options not available to the employer of the 1880s.

Filene argued in support of a decent minimum wage by reminding employers that there is a flow on effect, which bears reiterating: Cheap wages make cheap standards in employers which result in inefficient employees [23]. When employers pay a very low minimum wage, two things occur. Employers expect less from workers, and workers give less to employers. This is due to motivation factors, which can be described through such mechanisms as the expectancy theory [24] or the equity theory [25]. Others have found that:

> . . . [E]mployers who are extracting excess profit margins by under-remunerating labour can afford to raise wage rates without laying off workers,

> and can even increase their profits by hiring more workers at these higher rates . . . the "efficiency wage hypothesis" asserts that better-paid workers will be better nourished and more productive, so that mandated minimum wages are also an investment in higher productivity and economic growth [26, pp. 902-903].

Deltas' research shows that imposition of a minimum wage "has the effect of specifying a minimum acceptable worker effort [21]. If a worker who was paid less than the minimum wage does not increase his effort, he will not be able to retain his job" [21, p. 658]. This increases productivity through an increased effort.

More wealth creation will result when profit-sharing is used than when there is a wages system. Profit-sharing also allows for a more equitable distribution than does the wages system.

> A premise of all deductive economies is that self-interest is the chief motive in the creation of wealth. If this premise is valid, the wages system, judged by an absolute standard, is uneconomical. It enlists the self-interest of the wage-earner but partially. The great moral forces of his personality are not called into creative action. The fixed amount of his wages measures the effort that he feels disposed to make. On the other hand, the effort of the worker whose reward is to be a profit in some degree proportionate to his achievement is limited only by the limitations of his own physical, mental, and moral powers [8, pp. 367-368].

> . . . we are compelled to admit that profits may contain at any given time a sum in excess of the normal equitable reward of the services rendered by the employer—a sum which it will be the function of further competition to distribute with approximate equity. . . . Wages are not only paid out of capital, but, as Professor Henry Sidgwick has shown, they are not so much as advanced out of capital. Strictly speaking, they are simply capital in one form exchanged for capital in another form, the latter being the utility created by the laborer [8, p. 369].

Competition is not consistent; it fluctuates. It is, therefore, defective in distributing wealth or other items equitably [8]. Giddings supported profit-sharing because he believed that it did not limit competition but served to correct problems in competition at the point where they arise [8]. And can we argue with Ryan, when he specifies a living wage as access to:

> . . . food, clothing, housing sufficient in quantity and quality to maintain the worker in normal health, in elementary comfort, and in an environment suitable to the protection of morality and religion; sufficient provision for the future to bring elementary contentment, and security against sickness, accident, and invalidity; and sufficient opportunities of recreation, social intercourse, education, and church membership to conserve health and strength and to render possible the exercise of higher facilities [29, p. 115].

Filene [23] also proposed that paying a higher minimum wage would make employers interested in their community, e.g., public schools (to obtain workers that could justify earning $14 per hour) and housing (so that rents were not over-inflated). He believed that paying workers more would make employers value them more. "One feels greater responsibility for an important expense than for an unimportant one" [23, p. 413]. The largest expense in business is waste, according to Filene, and he cited the high wages paid by Henry Ford at his plant in Detroit as an argument for paying workers beyond the minimum to get them to show up for work. The Ford plant was considered one of the most efficient workplaces of the time [28].

CONCLUSION

Economists who predict job losses from the minimum wage may overlook these key points:

- Minimum wage workers can be consumers—raising wages is at the expense of the consumer, not the employer [29].
- Most economists assume a perfect market—however, in a tight labor market, most employers are monopsonists.
- Individuals are required to provide for their families through work, or the social welfare system must come into play, affecting the cost of goods and services and the purchases of these goods and services.

Neoclassical economic theory views workers as a means of production and competition as determining wages which are, in turn, lined to productivity. In the alternative view, wages are determined also by the needs of workers to subsist—adequate wages to purchase those goods and services necessary for survival. This is also called *the living wage.* Inequality is often the basis for determining economic injustice, so when we see workers who are earning very little or discrimination against a group of workers, we feel that there is economic injustice [30]. We have difficulties when (a) we see individuals working but unable to afford their basic material needs, (b) workers are forced to rely upon social welfare although they are producing a good or service, and ©) there are children of working parents falling below the poverty level.

For much of history, the only writings on ethical, just, or fair wages were by the Catholic Church, with the work of Thomas Aquinas becoming a part of the doctrine of the Church. Early economists believed that a day's work should earn a day's equitable wages, not a day's subjective wages. This is because subjectivity does not prove equivalence of value. They believed that subjectivity skewed the value of labor, goods, and services—a starving man might give his entire fortune for a loaf of bread. As the authority of the Church and the craft guilds waned, a greater fluctuation of prices resulted. The Classical Economists did not

recognize an imperfect market but made assumptions about free agreements of prices and wages made in perfect freedom and perfect competition [29].

Justice of wages is only applicable when both parties are acting justly—if one of the parties behaves unjustly, then unjust wages result. "It would be folly to condemn as unjust the wages paid in China merely because the workers there are unable to live in accordance with what we consider reasonable standards of health and decency. The economic conditions and the density of population in China make impossible an approach to the American standard of living" [29, p. 272]. Therefore, unjust can only apply to the way or process used to decide on the wage, not on the wage itself. So a just wage can only be allowed when workers are allowed to sell their goods in any labor market in a perfect market with perfect competition. However, it is rare that equality of the market exists [30].

Therefore, the economic system is not a perfect market, but instead has a measure of economic determinism which prevents increase in the final measure of labor productivity. Eugene Lyman believed that there are inequalities that come from the concentration on the market system as a perfect one.

> Thus the profits of the enterpriser are bound up with the perpetuation of inequalities of opportunity for labor. . . . the modern successors of Adam Smith . . .seem to persist in abstracting the economic world from the other spheres of human activity and assuming that in that world self-interest is the only motive to be reckoned with. . . . By insisting that self-interest is the only motive to be considered in determining the laws of the economic world, one tends actually to segregate the economic world from social motives [31, p. 102]. Past and present [economic] systems have a certain relative justification and at the same time involve certain obvious evils. . . . [There should be] a socializing of the economic motive and a democratizing of economic method, thereby securing greater justice in distribution of income, and, as I believe, an equal, if not greater, productivity on the part of society [31, p. 107].

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