# The Two Moralities of the Minimum Wage

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> If we were to apply the unmodified, uncurbed, rules of the micro-cosmos (i.e., of the small band or troop, or of, say, our families) to the macro-cosmos (our wider civilization), as our instincts and sentimental yearnings often make us wish to do, *we would destroy it*. Yet if we were always to apply the rules of the extended order to our more intimate groupings, *we would crush them*. So we must learn to live in two sorts of worlds at once.
>
> —F. A. Hayek, *The Fatal Conceit* (emphasis in original)

Most supporters of the minimum wage see it as a moral issue. Even when they follow arguments based on the logic of supply-and-demand analysis and unintended consequences (although most don't bother), they remain convinced that having a minimum wage and increasing it occasionally is the moral thing to do. As Joseph Schumpeter pointed out, "The stock exchange is a poor substitute for the Holy Grail" (1950, 137). The importance of morality over economic logic in motivating political support for the minimum wage and many other government policies is accentuated by the ability to express one's moral virtue at little personal cost through voting.

The purpose of this paper is to put forth a convincing moral case against the minimum wage. Accomplishing this purpose is more difficult than pointing out that the minimum wage results in outcomes counter to those supporters consider moral,

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although doing the latter is also important. Making a convincing moral case against the minimum-wage legislation requires that we consider two moralities, the first of which explains the political popularity of the legislation and the second of which explains why it harms low-wage workers, in particular those most in need of help. The first morality is appropriate for families or small groups in which members are familiar with and have personal concern for each other. I call this "magnanimous morality." The second morality is suitable for large groups in which members have little knowledge of or personal concern for each other. I call this "mundane morality." Both moralities, when practiced within their proper spheres of human interaction, make the world a better place. But the strong emotional appeal of magnanimous morality creates temptations to apply it to large-number situations, such as markets, where it does more harm than good by hampering the cooperation between large numbers of strangers that cannot be achieved without reliance on mundane morality.[1]

After discussing magnanimous and mundane morality, I argue that much, though not all, of the political support for minimum-wage legislation comes from its being seen as motivated by the former morality. I then point out that it is the exercise of markets' mundane morality rather than a minimum wage that provides the only serious hope for low-wage workers to improve their real incomes. Indeed, most of us would earn less than the current minimum wage if it were not for the impressive social cooperation that would be impossible without mundane morality. Our general well-being is eroded when politicians attempt to substitute policies motivated by magnanimous morality for the extended cooperation made possible by mundane morality, as is the case with minimum-wage legislation, which inflicts the greatest harm on those we want to help: low-wage workers.

## Magnanimous versus Mundane Morality

Magnanimous morality can be described briefly as helping others intentionally and doing so at some personal cost with the help going to identifiable individuals or small groups. This willingness to assist others clearly had survival value during most of human history when we subsisted in small groups of hunters and gatherers, and it became reinforced through the evolution of strong emotional responses that favored this behavior and identified it as moral. The emotional appeal of people making personal sacrifices to intentionally help identifiable others is evident from literature, news stories, and our personal experiences. Magnanimously moral behavior by others elevates them in our estimation, and we experience a sense of moral satisfaction when we engage in or convince ourselves that we are engaging in such behavior.

1. My distinction between magnanimous morality and mundane morality is directly related to the distinction Friedrich Hayek makes between the rules of the microcosmos and the rules of the extended order (1988, 18), as in this essay's epigraph. It is not too strong to say that Hayek's insight on the importance of making the best use of both of these moralities provides the basis and inspiration for the current paper.

As desirable as magnanimous morality continues to be in small groups, it is important to recognize that its strong appeal in comparison to that of mundane morality can and commonly does motivate unfortunate public policy.

Mundane morality is briefly described as obeying general rules that promote the common welfare when widely adhered to. The best example of mundane morality for purposes of this paper is obeying the rules of private property and voluntary exchange upon which Adam Smith's "invisible hand" metaphor is based ([1776] 1981, 456). Paraphrasing Smith: by pursuing our own interests, subject to the rules of the marketplace, we are led by an invisible hand to unintentionally do more to promote the public interest than if we intended to promote it. Economists applaud Smith's invisible hand of the market and the mundane morality that helps enforce the general rules necessary for its operation because they understand the difficulty of getting multitudes of strangers to cooperate with each other in mutually beneficial ways.[2] Of course, anyone who has read Smith's first book, *The Theory of Moral Sentiments* ([1759] 1982), realizes that he also understood the importance of magnanimous morality in our everyday activities, including market exchanges. The impersonal exchanges among strangers that rely almost completely on mundane morality and from which we all benefit are commonly connected with and depend on exchanges that rely on very personal and long-lasting relationships that are greatly facilitated by magnanimous morality.

For many people, however, relying on mundane morality and the invisible hand of impersonal exchange dominates their view of what motivates market behavior and the benefits that result from that behavior. With the morality of helping others instinctively understood in terms of magnanimous motivations, the invisible hand of the market is widely seen as violating every tenet of morality. The help motivated by the invisible hand is provided unintentionally, is motivated by the desire to promote self-interest (no sacrifice required), and is provided to the general public (no one in particular) instead of to identifiable individuals or groups. Thus, the case for relying on mundane morality and the invisible hand of the market has little, if any, emotional appeal, and many see it an excuse for greed. Even those who recognize the desirable outcomes of markets often see those outcomes as contaminated by the unsavory motivation that generates them.[3]

2. Not surprisingly, Smith emphasized the moral virtue of obeying general rules when he stated, "[W]ithout this sacred regard to general rules, there is no man whose conduct can be much depended upon. It is this which constitutes the most essential difference between a man of principle and honor and a worthless fellow" ([1759] 1982, 163).

3. For examples of the ignoring and rejection of effective market approaches to helping people in favor of less-effective approaches relying on magnanimous morality, see Clark and Lee (2011). Similarly, when problems are caused by government policies that impose restrictions on markets, discussions of solutions to those problems often ignore the market restrictions. For example, discussions of the high levels of unemployment among young people commonly fail to mention the obvious contribution of minimum-wage laws to this problem. This was the case in a segment on National Public Radio's *Weekend Edition* aired on September 7, 2013.

## The Political Appeal of Minimum Wages

If all wages were determined by market forces, some workers would earn incomes widely considered as unacceptably low, and most of us would like to see something done to help those workers. Having the government establish a wage below which wages cannot legally fall is widely seen to be a direct and effective way of providing that help. It also has the advantage of being seen as a policy motivated by magnanimous morality. This view is regularly reinforced by advocates of the minimum wage, who portray it as intentionally helping an identifiable group (low-wage workers) by our willingness to pay more for certain goods and services. The rhetoric of magnanimous morality in support of minimum-wage increases is often used to obscure motivations that are hardly magnanimous. For example, labor unions support a higher minimum wage by claiming to be concerned with the welfare of all workers, but in reality they see a minimum wage as an effective way of making it illegal for low-skilled workers to compete against union members by accepting lower wages.[4]

Of course, consumers often assume that a higher minimum wage won't increase the prices they pay but will be paid for in the form of lower profits, with income being transferred from greedy employers to deserving workers. This is consistent with Paul Rubin's observation that "those untrained in economics think of prices as allocating wealth but not as influencing allocation of resources or production of goods and services" (2003, 157). So a higher minimum wage is widely seen as increasing the amount that low-income workers are paid, but with little, if any, attention given to the possibility that many of those workers will lose their jobs and even less attention given to reductions in on-the-job training and lower future productivity and earnings for those who keep their jobs.

Not surprisingly, supporting an increase in the minimum wage is widely seen as noble, and opposing an increase is just as widely seen as heartlessly abandoning our most vulnerable citizens to impersonal markets motivated by greed. This view, for a voter who holds it, will dominate any financial concerns he might have about a higher minimum wage in determining how he will vote. The probability is vanishingly small that his vote will determine the outcome of an election with many voters, as is the influence of his voting decision on his personal costs. The feeling of moral virtue he realizes from his vote, however, is determined decisively by how he votes. Therefore, if voting to express support for a higher minimum wage gives a voter even a small feeling of moral virtue, that benefit is surely worth more to him than the financial cost of his vote.[5]

4. Of course, support for a host of policies that harm those who are supposedly being helped is invariably expressed with the rhetoric of magnanimous morality.

5. In elections in which no one's vote is likely to be decisive, expressive benefits dominate financial benefits in determining how an individual votes. See Brennan and Lomasky (1993) and Caplan (2007) for book-length treatments of what has become known as "expressive voting." For a discussion of a widespread tendency for people to erroneously see the political process as morally superior to the market process that considers expressive voting, see Lee (2010).

Even if economists convince the public that increasing the minimum wage reduces the prosperity of the economy, a common response will be that the cost of some reduction in prosperity is a price worth paying for a more moral society. The best hope for overcoming this moral response to the standard economic argument against the minimum wage is by distinguishing between magnanimous and mundane morality and explaining why political attempts to expand the former with minimum-wage increases invariably weakens the social cooperation that requires the latter, with the result that we end up with less prosperity *and* less morality.

As important as magnanimous morality is to mutual assistance within small groups in which people know and care for each other, the magnanimous hope for a world in which people extend help to and receive help from many millions of others depends on maintaining primary reliance on the mundane morality of markets.

## The Mundane Morality of Multitudes Helping Each Other

No matter how talented a person is or how hard she works, her real wage depends on the decisions of a multitude of others, most of whom will never know she exists. Her productivity is obviously important, but her productivity is limited by how much others decide what she produces is worth. Also, her real wage will not be very high no matter how much value she produces for others unless others are producing things she values. So high real wages require an economy that makes it possible for (1) others to inform each of us how much they value the things we are able to produce for them; (2) each of us to inform others how much we value the things they are able to produce for us; and (3) an incentive to be embedded in the information that motivates us to make use of it by specializing our efforts in ways that best serve the interests of others. Such an extended network of mutual assistance would be impossible without widespread respect for and adherence to the mundane morality of markets and the market prices that result.

Market prices (including wages) emerge from voluntary exchanges of labor and privately owned goods and resources that communicate constantly changing information on the value consumers place on additional units of many thousands of products and the costs of producing additional units of each. These prices not only contain information on how to best help countless others but also provide incentives for people, as both producers and consumers, to provide that help. As producers, individuals consider the value of their productivity to consumers when training for occupations, as do firms when hiring and providing additional training for their workers. Each firm cooperates with other firms in jointly maximizing consumer value by expanding the employment of workers (and other inputs) only as long as the additional employee increases the value of output by at least as much as he (it) would increase value in the best alternative employment, measured by market prices.[6] Similarly, consumers share with each other for the benefit of all in that each increases his consumption of a good only as long as the marginal value he realizes from doing so is at least as large as the marginal value other consumers realize from the good, as measured by market prices.[7]

It is because multitudes of strangers are helping each other that real wages are invariably higher in market economies than they are in those economies directed primarily by government planners, who can never acquire the information that is being constantly adapted and communicated through market prices. Without mundane morality helping to motivate adherence to the rules of market exchange, achieving anything close to the purchasing power provided by today's federal minimum wage of $7.25 per hour would be little more than a fantasy for most of us.[8] But for the very reason that the mundane morality of markets makes possible high real wages, minimum-wage legislation harms many low-wage workers and hurts those lowest-paid minimum-wage workers the most.

## Harming Those We Want to Help

Markets, when backed up by mundane morality, motivate productive cooperation among multitudes of strangers by providing each of us with credible expectations that our help to others will be sufficiently reciprocated to leave everyone better off. For an individual to take full advantage of this productive cooperation, he has to be able to reciprocate the benefits he receives from the effort of others by repaying at least their costs with his own effort.[9] This explains why the minimum wage harms workers it is supposed to help—those whose skills are currently insufficient to produce value equal to the minimum wage. These people are prevented from participating in the market network of productive cooperation because the minimum wage makes it illegal for them to accept a wage low enough for them to fully reciprocate the value others

6. This implies that workers are hired by those firms where they have a marginal value at least as high as they would have elsewhere and therefore that their employers are paying them a wage at least as high as any other firm is willing to pay them. There is a clear morality to this result, but one that can be achieved only through the mundane morality upon which market exchange depends.

7. No economy will achieve the perfection described here, but economies relying primarily on the mundane morality of private markets largely open to competitive entry make possible a far more impressive amount of mutual assistance over an extended social order than do economies directed primarily by government controls. Those controls are commonly claimed to be motivated by magnanimous morality, but regardless of their motivation they distort and destroy the ability of mundane morality and market rules to generate the price information required for widespread cooperation.

8. The important economic role of government in assisting in the enforcement of the rules of private property and voluntary exchange upon which markets depend should be acknowledged. But without the internal moral checks on opportunistic behavior provided by mundane morality, effective government enforcement of general rules, no matter how socially beneficial they are, would be impossible without destroying the individual freedom upon which markets depend. See Rose (2011) and Stringham (2011).

9. It would have been easier to say the individual has to be able to reciprocate by returning to others the value he receives from them. But this would suggest that market exchange implies the transfer of equal value, which is not true. People engage in an exchange when they expect it to be a positive-sum activity, meaning no party to the exchange ends up worse off and at least one party ends up better off.

(ultimately consumers) are paying for their labor. The result is that many are prevented from getting the work experience that is their best hope for increasing their productive skills and, consequently, from doing more to improve their own lives by doing more to help improve the lives of others.

Fortunately, most of us have the opportunity and encouragement in our early years to acquire the skills necessary to qualify for minimum-wage jobs when we are young and then to qualify for jobs paying far more when we are adults. Having role models with productive jobs, having an effective K–12 education that ignites the joy of learning, joining social organizations, doing volunteer work, graduating from high school, and earning a college degree are all things that result in acquiring the social and occupational skills necessary for jobs that are personally satisfying and financially rewarding. For those fortunate enough to experience these advantages (or even some of them), the minimum wage has no noticeable effect on their opportunities.

The minimum wage has regrettable effects, however, by reducing the opportunities that would otherwise be available to young people who do not have such advantages. Because of deficiencies in their K–12 education, lack of family and financial support, and other disadvantages, the best hope many young people have for developing employable skills that will pay off later is on-the-job training now. This means getting a job with real responsibilities—one requiring them to provide a service that is worth at least as much as they are being paid. Without a minimum wage, getting such a job and learning productive skills and the importance of dependability would be relatively easy for a young person lacking job experience and productive skills. She could agree to work initially for a wage low enough to make it worthwhile for someone to hire her, which would give her the opportunity to begin helping others by performing simple tasks while receiving training for more demanding responsibilities later. This is what college students do when they take unpaid summer internships with nonprofit organizations to gain valuable experience that will benefit them later. If such unpaid internships provide useful work experiences for young people in college, why is it a good idea to deny real-work experiences for less fortunate young people unable to attend college because their skills are currently worth less than $7.25 an hour?[10]

Although young workers from disadvantaged backgrounds do get jobs paying the minimum wage, they benefit less than minimum-wage advocates claim. Employers can offset the additional monetary cost required by a minimum-wage increase by reducing the nonmonetary compensation of low-wage workers. Minimum-wage workers often receive part of their compensation in the form of fringe benefits

10. Members of the U.S. Congress advertise unpaid internships for college students by pointing out that young people benefit from work experience in beginning-level jobs requiring little experience even though the jobs pay nothing. One wonders why members of Congress are providing young people who have plenty of advantages the opportunity to further improve their prospects in nonpaying jobs doing low-skilled work, while at the same time passing minimum-wage laws that deny disadvantaged young people the opportunity to acquire similar work experience unless they can find jobs paying them at least $7.25 per hour. See Lee (2013).

such as training opportunities, insurance, child care, flexible working hours, and paid vacations. After a minimum-wage increase, however, these benefits can be and often are reduced or eliminated entirely, allowing employers to satisfy the law without increasing their workers' compensation by as much as the required monetary increase, if at all (see Gorman 2008). Because fringe benefits make sense only when they are worth more to employees than they cost employers to provide, even a worker who keeps her job after a minimum-wage increase will be less well off than her higher money wage indicates—and she may be even worse off because of the loss of fringe benefits. Furthermore, the ones who are harmed the most are the lowest-paid minimum-wage workers—those who are receiving no fringe benefits and therefore are most likely to lose their job after a minimum-wage increase because they have no fringe benefits to take away.

It should be pointed out that reductions in fringe benefits *dampen* the unemployment effect of a minimum-wage increase relative to what would be expected if total compensation of minimum-wage workers were to grow by the same amount as the minimum-wage increase. This can explain why some minimum-wage studies find little change in employment after a minimum-wage increase. Indeed, one of the most noted minimum-wage studies concluded that employment in fast-food restaurants increased in New Jersey relative to employment in the adjacent state of Pennsylvania after New Jersey increased its minimum wage while Pennsylvania left its minimum wage unchanged (see Card and Krueger 1994). This, of course, is not likely explained by reductions in fringe benefits. But the study by David Card and Alan Krueger has been challenged on the grounds that it is based on employment data gathered by telephone surveys. A study by David Neumark and William Wascher (2000), using actual payroll data from a set of restaurants in New Jersey and Pennsylvania comparable to those in the Card and Krueger study, found that the New Jersey minimum-wage increase resulted in a statistically significant 4.6 percent decrease in employment compared to the control restaurants in Pennsylvania. And even this decrease in employment is surely less than it would have been if New Jersey employers had not, as many surely did, kept their total compensation to minimum-wage workers from increasing as much as the minimum-wage increase by reducing fringe benefits.

## Conclusion

No serious person questions the satisfaction and fulfillment we receive from the love and devotion of our family and friends and that we have for them. Within those small groups of people who mean the most to us, magnanimous morality is the best way to motivate the reciprocity and cooperation that emerges from informal understandings and norms. Any attempt to substitute the formal rules and contractual obligations associated with the mundane morality of markets for the magnanimous morality of small groups would be ruinous. The emotional appeal of magnanimous morality as the most, if not the only, acceptable source of human cooperation is not surprising.

Because of that emotional appeal, however, it is important for economists to emphasize the limits to magnanimous morality and explain why attempts to increase reliance on it beyond those limits lead to outcomes quite the opposite of those hoped for. The desire to apply that morality to labor markets with minimum-wage legislation is just one of many unfortunate examples of a failure to recognize its effective limits, and it is surely not even the most costly instance. But it is a useful example of the more general task economists confront in their attempt to make a convincing moral case for markets. It is not an easy moral case to make, given the emotional appeal of magnanimous morality and the importance people place on intentions. But the best hope economists have for making the moral case for markets generally is that the mundane morality of markets is the only way of achieving the magnanimous objectives of social cooperation and mutual assistance on a global scale. Those outcomes achieved by the mundane morality of markets in an extended social order may not be intended, but they will be magnanimous. In contrast, the outcomes that can be achieved by magnanimous morality alone in an extended social order will be neither intended nor magnanimous.

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