Opinion **Free Lunch**

The meaning of Amazon's wage rise

Better entry-level pay has ramifications far beyond the online giant's workers

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The decision by Amazon to raise its US entry-level wage to $15 an hour, announced at the start of October, is obviously good news for its workers. Beyond that, it is a small gift to those interested in economics and political economy, because the pay rise triggers some intriguing thoughts and speculations.

First, an obvious point: this is not a "minimum wage", a term that should be reserved for legally required wage floors. There is an important difference between voluntarily setting a floor for entry-level employees' pay and being forced to pay above a certain amount.

Second, Amazon can clearly afford the increase. Analysts estimate it will cost less than 1 per cent in revenue, and that is even if it does not result in any productivity gains, if it is not rewarded by customers more willing to shop with Amazon and if the company does not pass on any of the increased costs through higher prices. In fact, there is plenty of evidence that productivity will be boosted, for example by reducing turnover and raising staff morale.

That means, third, that Amazon could have afforded a legal minimum wage of $15 an hour, too. Its decision seriously weakens those who argue against minimum wages at such levels on the grounds that it would put companies out of business.

Fourth, however, it may well be that not every company could absorb such a wage floor. But that may be just why Amazon is doing this voluntarily, in the expectation that it will put a greater burden on competitors and allow it to eat into their market share. That is consistent with the fact that it will now lobby for a higher federal US minimum wage, forcing its rivals into a cost increase that may hurt them harder than it. But if so, we should applaud it: shifting resources into the more efficient companies that can afford higher wages, away from the less efficient ones who cannot, is the way productivity in an economy and higher pay can be sustained as a consequence.

Fifth, why don't other companies make a similar move? Actually, many have — Walmart and Aetna both did in 2015, for example. For those that do not, short-sightedness is part of the reason; the documented productivity effects of treating workers better are not always and everywhere appreciated. But to the extent the cost of higher pay must in part be passed on to consumers, strong price competition may make it very hard to move alone except by the most productive (and highest-margin) companies. That means (legal) minimum wage rises are good for business. It is in their interest for all to be forced to do what they individually cannot risk.

Sixth, of course, Amazon may have other motivations for taking this step now. It has been targeted by campaigners and politicians not just over pay, but over the undignified working conditions in its warehouses and the way it uses its heft to push against unionisation efforts or tax and other policies it does not like. This decision is a reputational coup that takes the pressure off. In addition, the company may be expecting the push for higher legal minimum wages to succeed (or tight labour markets to drive up wages regardless) so that it is simply embracing a change it would later be forced to make.

Finally, a much more wide-ranging thought. Could the change harbour a bigger transformation in the political economy of the US and other countries? If it does increase the likelihood of more widespread wage rises at the low end of the labour market, we should consider the implications for markets and the rest of the economy. Lukasz Rachel notes that the Amazon announcement was followed by a rise in market yields for US Treasury bonds and a drop in stock prices. This was probably just a coincidence. But there is reason to think that broader upward pressure on the lowest wages — and the lesser income inequality that this would portend — could indeed raise interest rates and make equities less attractive in the long run.

A more equal income distribution would shift purchasing power from the high-paid and capital owners to the low-paid. Since the latter tend to spend more of their income, this would bring downward pressure on the portion of national income that is saved and upwards pressure on the portion consumed; or equivalently, tend to push up consumption and push down investment in national expenditures. This would raise the interest rate that equilibrates savings and investment.

The plausible long-term result would be higher average interest rates and larger current account deficits over time, depending on how open the economy in question is; in the US the biggest impact would be on interest rates. (Indeed, Rachel himself and Thomas Smith have published estimates suggesting greater inequality has lowered global equilibrium interest rates by about half a percentage point since the late 1980s.) Higher equilibrium interest rates should, in turn, keep equity prices lower over time than they would be otherwise.

This is all highly speculative. But it illustrates that a general move towards better conditions for the worst-paid, welcome as it would be, has complex economic and political economy ramifications. Far-sighted politicians will need to think about how to address them.

Other readables

- Don't miss two riveting longer reads on the process and politics around Brexit. The first is my colleagues' magazine profile of Olly Robbins, the UK civil servant in charge of negotiations. The second is a speech on the Brexit revolutionaries by Ivan Rogers, who had to grapple with them as UK permanent representative to the EU.