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VIRTUE, LIBERTY, & INDEPENDENCE

MINIMUM WAGES:
ECONOMICS 101 REVISITED

by

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THE DEBATE

The Congress is currently considering a bill to raise the minimum wage to $5.15 per hour in two steps from the present level of $4.25. Supporters believe that raising minimum wages will reduce poverty with no appreciable harmful effects to the economy. Unfortunately, there is no free lunch and the supporters are disingenuous. This government intrusion in the market place will create more unemployment and increase the welfare rolls. Of course, the cynic would point out that advocates of higher minimum wages would welcome additional problems for the government to solve.

THE PROBLEM ... WITH GOVERNMENT REGULATED WAGES BEING SET HIGHER THAN THE MARKET CLEARING PRICE IS THAT IT CREATES AN INCENTIVE FOR EMPLOYERS TO CUT COSTS BY REDUCING THE NUMBER OF PEOPLE HIRED AT THE MINIMUM WAGE AND/OR BY REDUCING BENEFITS.

In the real world, when the government sets the minimum allowable wage above the market clearing price, an incentive is created for employers to cut costs by reducing the number of people hired or by reducing benefits. For example, Murray Weidenbaum (The Freeman, November 1994) reports that retail firms in New York responded to increases in the minimum wages by "reducing commission payments, eliminating bonuses, and cutting paid vacations and sick leave."

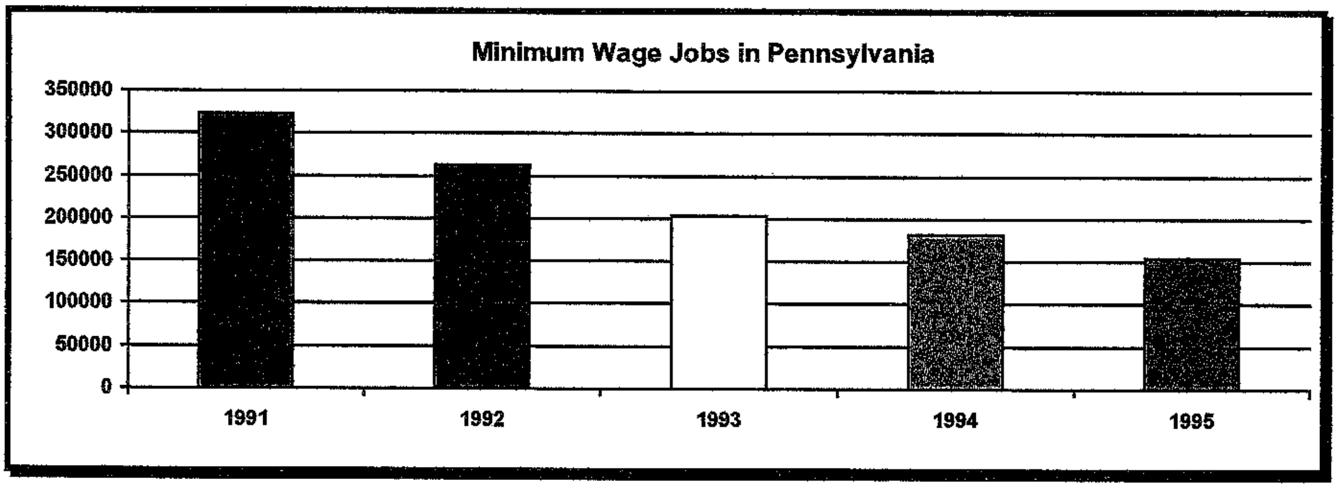
Advocates of the minimum wage, especially politicians frequently misquote a study produced by David Card of Princeton University and Alan B. Krueger, the chief economist at the U.S. Department of Labor. That work analyzed the effect of minimum wage increases on the fast-food labor market in New Jersey. Krueger and Card concluded that a rise in the minimum wage does not significantly affect teenage unemployment rates. In fact, their study revealed a small positive relationship between employment and minimum wages, but as Card and Krueger clearly noted the estimates were not significant and therefore, contrary to those who misuse the report, no positive relationship between minimum wage and employment can be claimed.

Furthermore, the Krueger-Card study has been roundly criticized by the economics profession. The major complaints focus on the methodology used. Consider that the study examines only one industry, which is known to have a high turnover rate while the length of time necessary for changes to take place may indicate that the study did not encompass enough time. David Neumark, a professor at Michigan State University, and William Wascher of the Federal Reserve, repeated Krueger and Card's study, but analyzed in-depth the payroll data records of the fast-food industry. They found that after minimum wages increased, employment in New Jersey dropped 5 percent. Further, Neumark and Wascher found that employers were offering more hours to higher skilled teenagers at the expense of the lower skilled. As a consequence higher-skilled teenagers went from being "in school and employed to being out of school and employed. Some of the least skilled teenagers, however, [were] priced out of the labor market, and their status change[d] from out of school and employed to neither in school nor employed."

THE PROPOSED MINIMUM WAGE INCREASE IN PENNSYLVANIA COULD TRANSLATE INTO AS MANY AS 33,000 LOST MINIMUM WAGE JOBS.

THE COSTS

Meanwhile, Murray Weidenbaum of the Center for Study of American Business estimates that a 10% increase in minimum wage costs increases unemployment by approximately 1 - 3% for those who hold minimum wage jobs. In Pennsylvania, where there the state house has voted to raise the state's minimum wage by $1.50 over three years - as many as 33,000 jobs could be lost. In Allegheny County, the proposed wage increase could lead to about 4,000 jobs lost. Beyond the employment reductions, there will be cuts in hours worked and income for many who keep their jobs.



HELPING THE POOR?

Proponents of a higher minimum wages often use the argument that the minimum wage is not enough to support a family of four. Of all the reasons given to increase the minimum wage that has to be the most absurd. First of all, in a competitive market, wage rates will reflect the worker's contribution to a firm's production and revenue. For the most part, the productivity of workers in the unskilled, entry level jobs that pay minimum wage bears little relationship to marital status or number of children of the worker. There is simply no practicable, fair way to increase the pay of workers according to their demographic characteristics as opposed to their contribution to their employer.

Second, to support a family of four at the poverty level would require that a breadwinner earn $8 or more per hour. Therefore, the dollar an hour increase being talked about in Congress is woefully inadequate to achieve the goal of making the minimum wage a "living" wage. Any serious proposal to raise the minimum to $8 would be immediately dismissed as ridiculous. But a temporizing rise of $1, the cost of which must be borne largely by small businesses and the workers who lose their jobs, is treated with solemnity and a lot of self congratulation by supporters of the higher wage.

Moreover, the family of four argument is a red herring in that only a very small number of American families have a chief breadwinner earning the minimum wage. According to the Wall Street Journal of April 16, 1996, Bureau of Labor Statistics figures place the heads of household earning minimum wage at just 210,000, about 0.2 percent of all households. This limited number of beneficiaries of a mandated wage hike hardly justifies a massive interference with market mechanisms, especially in view of the number of government programs available to low income people.

That being the case, who are the minimum wage earners? In 1995, there were 3.7 million such workers, about 2.8% of the entire US labor market. They break down as follows:

36.9%	*Full -Time Employees*
31%	*Teenagers*
54%	*Under The Age Of 24*
81.9%	*White*
13.6%	*Black*
30.1%	*Men*
4.2%	*Worked In Pennsylvania*
56%	*Worked For Service Occupations (E.G., Private Household, Protective Services, Food Service, Health Service Workers, Etc.),*
20.5%,	*Worked In Technical, Sales, And Administrative Support Areas*
92.6%,	*Work For The Private Sector*
38.8%,	*Have Less Than A High School Diploma*
24.6	*Have Some College But No Degree,*
40%.	*High School Dropouts*

Does the minimum wage help the poor? Professor Richard Burkhauser of Syracuse University wrote an essay for the Center for Economic and Policy Education at Saint Vincent College examining better ways to target help for the working poor. He concluded that the minimum wage is not an effective way to help. Burkhauser noted that about 53% of US minimum wage workers live in families whose incomes exceed the poverty line by a factor of two - that is - income levels of over $30,282 for a family of four in 1994. Only 22% of the total number of those working for the minimum wage live in families below the poverty line. Professor

Burkhauser also concluded that the job loss effects of increasing minimum wages primarily will fall on that 22%, because they tend to be less educated and lower-skilled. All in all, using the minimum wage as an antipoverty policy makes no sense.

CONCLUSION: NO FREE LUNCH

IF LEGISLATORS WANT TO GIVE MINIMUM WAGE EARNERS A RAISE, WHY NOT CUT PAYROLL AND INCOME TAXES?

To conclude, the minimum wage increase is no free lunch. Consumers will pay more. (Do you think it is primarily the rich that eat at fast-food restaurants?) Employees will lose benefits, low-skilled workers will face greater difficulties obtaining entry level jobs and there will be more unemployed teenagers. The social consequences that accompany that teenage unemployment will escalate. More people will go on welfare as a result of increasing unemployment. Then too, as noted by Paul Merski of Citizens for a Sound Economy, second incomes will be in jeopardy due to the scarcity of minimum wage jobs. Support for the increase is totally political; the economics and the facts say it is folly.

A straightforward example will illustrate:

Suppose you own a small business or are thinking about starting one and PA increases the state minimum wage by 20%. What will you do?

A. Go out and hire more employees.

B. Downsize or start up in some other state.

In all probability, 99% of this paper's readers will answer this question correctly and sensibly. Unfortunately, the 1% who will get it wrong includes a number of our legislators. If our legislators, state or Federal, want to give minimum wage earners a raise why don't they simply cut their payroll and income taxes? They could pay for the tax revenue reduction through expenditure cuts. But don't count on it.