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Minimum Wage: The Ups & Downs

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Politicians — particularly Democrats — have been stumping for an increase in the federal minimum wage for some time now. And with 2014 being an election year, the calls for hiking the wage from $7.25 an hour to $10.10 an hour — a 39-percent jump — are growing ever louder; and they are getting results.

The nation's politician in chief, President Barack Obama, called for a minimum wage hike in his last two State of the Union addresses. In 2013 he said, "Let's declare that in the wealthiest nation on Earth, no one who works full-time should have to live in poverty, and raise the federal minimum wage to $9.00 an hour." Such a move, he claimed, would "raise the incomes of millions of working families," stimulate the economy, and reduce dependence on government handouts.

This year, having upped the ante to $10.10 an hour, Obama called on Congress to put the minimum wage increase to a vote. "You've got a choice," he said. "You can give America the shaft, or you can give it a raise." That remark drew "thunderous applause" from the audience at the University of Michigan, reported the *New York Times*.

While Congress has thus far refused to pass a bill raising the federal minimum wage, there has been considerable action on the state level. As of this writing, 10 states plus the District of Columbia have increased their minimum wages since February 2013, and most of the remaining states — and even some cities — are considering doing so.

"The result is an outside-the-Beltway variation on Mr. Obama's pledge to use his executive powers to bypass an obstructionist Republican Party in Congress," the *Times* observed. "In this case, White House aides said they believed that Mr. Obama's feverish rhetorical push for a higher minimum federal wage … has helped generate political pressure on states to act."

Meanwhile, inside the Beltway, Obama issued an executive order in February imposing his preferred minimum wage on federal contractors — a move of rather dubious legality, as we shall see.

The rhetoric from Obama and other proponents of a minimum wage hike suggests that the government can, by mere fiat, repeal the law of supply and demand. These people seem to believe that increasing the cost of labor will have no effects other than putting more cash into laborers' hands. However, as the Cato Institute's Mark Wilson pointed out in a 2012 report, "The higher costs will be passed on to someone in the long run; the only question is who."

Brother, Can You Spare $10.10?

First and foremost among those paying for a minimum wage boost are those who are — or would like to be — employed at the present minimum. Wrote Wilson:

The main finding of economic theory and empirical research over the past 70 years is that minimum wage increases tend to reduce employment. The higher the minimum wage relative to competitive-market wage levels, the greater the employment loss that occurs. While minimum wages ostensibly aim to improve the economic well-being of the working poor, the disemployment effects of minimum wages have been found to fall disproportionately on the least skilled and on the most disadvantaged individuals, including the disabled, youth, lower-skilled workers, immigrants, and ethnic minorities.

It's not difficult to understand why this is the case. Consider a teenager applying for his first job. He probably has few skills relevant to the job and no work experience. He will be relatively unproductive at first, perhaps generating just eight dollars per hour of revenue. If the minimum wage is $7.25 an hour, he may be hired; but if the minimum is hiked to $8.01 or higher, he will not. Instead, prospective employers will hire already skilled workers or automate jobs that were previously performed by unskilled workers.

Those unskilled workers who manage to retain their jobs despite the mandated raise won't necessarily be better off, either. Their employers are likely to reduce fringe benefits and on-the-job training to help offset the higher wages. "This is why labor force participation rates fall and quit rates rise when the minimum wage rises, in contrast to what would happen if those workers were made better off," Gary Galles observed in a piece for the Ludwig von Mises Institute.

None of this is breaking news, Wilson noted:

Evidence of employment loss has been found since the earliest implementation of the minimum wage [the 1938 Fair Labor Standards Act (FLSA)]. The U.S. Department of Labor's own assessment of the first 25-cent minimum wage in 1938 found that it resulted in job losses for 30,000 to 50,000 workers, or 10 to 13 percent of the 300,000 covered workers who previously earned below the new wage floor.

Particularly hard-hit by the new law were poorer areas, especially Puerto Rico, where, according to Wilson, "an estimated 120,000 workers … lost their jobs within the first year of implementation … and the island's unemployment rate soared to nearly 50 percent." Congress soon passed an amendment to the FLSA establishing special committees to determine the appropriate minimum wage levels for Puerto Rico and the Virgin Islands.

Since then, Congress has increased the minimum wage 22 times and expanded the law's coverage to about 85 percent of the workforce; and with each increase, the results have been the same. The most recent FLSA amendments raised the minimum wage in the states incrementally from 2007 to 2009 and provided for a longer phase-in period for the Northern Mariana Islands and American Samoa to bring them up to parity with the rest of the country. Despite this extended rollout, the wage hike took such a toll on the economy of American Samoa that Congress passed and Obama signed legislation postponing some of the increases.

The same employment effects occur when states raise their minimum wages. Most states have their own minimum wages, and under the FLSA, state minimums higher than the federal minimum take precedence. A March study by the American Action Forum found that

in 2013, a $1 increase in the minimum wage [above the federal level] was associated with a 1.48 percentage point increase in the unemployment rate, a 0.18 percentage point decrease in the net job growth rate, a 4.67 percentage point increase in the teenage unemployment rate, and a 4.01 percentage point decrease in the teenage net job growth rate. Consequently, high state minimum wages increased unemployment by 747,700 workers and reduced job growth by 83,300 jobs.

Likewise, a 2012 study by Joseph Sabia, Richard Burkhauser, and Benjamin Hansen concluded that New York's 2004-2006 $1.60-per-hour minimum wage hike was "associated with a 20.2 to 21.8 percent reduction in the employment of younger less-educated individuals, with the largest effects for those ages 16-to-24."

Nor are the unemployment effects of the minimum wage limited to the United States. According to a report by Johns Hopkins University economics professor Steve Hanke, the 21 countries in the European Union (EU) that impose minimum wages had an average unemployment rate of 11.8 percent in 2012, while the average rate among the remaining seven countries was just 7.9 percent. Furthermore,

In the twenty-one E.U. countries where there are minimum wage laws, 27.7% of the youth demographic — more than one in four young adults — was unemployed in 2012. This is considerably higher than the youth unemployment rate in the seven E.U. countries without minimum wage laws — 19.5% in 2012 — a gap that has only widened since the Lehman Brothers collapse in 2008.

Recent reports indicate that another U.S. minimum wage hike will continue the job-killing pattern of previous ones. In February, the Congressional Budget Office (CBO) projected that the proposed increase could cost as many as *one million jobs*. The March Duke University/*CFO* magazine Global Business Outlook Survey found that nearly half of U.S. retail firms and about a third of U.S. service and manufacturing firms would reduce jobs if the minimum wage were hiked to $10.10 an hour. That same month, Express Employment Professionals, the nation's largest privately held staffing firm, released a survey of small businesses revealing that 19 percent would cut jobs and 39 percent would reduce hiring under the same minimum wage increase. Even worse, of those businesses that currently pay the minimum wage to some of their employees, 38 percent said they would lay people off and 54 percent would hire fewer.

With Friends Like These…

Thus, there is no doubt whatsoever that raising the minimum wage will result in significant job losses. What's more, those losses will be concentrated in those groups that proponents of the wage hike claim to be trying to help.

"The minimum wage has its greatest impact on the market for teenage labor," wrote Harvard University's Greg Mankiw. "The equilibrium wages of teenagers are low because teenagers are among the least skilled and least experienced members of the labor force.... As a result, the minimum wage is more often binding for teenagers than for other members of the labor force."

According to Mankiw, "The typical study finds that a 10 percent increase in the minimum wage depresses teenage employment between 1 and 3 percent." Imagine what a 39-percent increase would do.

Minorities, who in many instances are already struggling to find work, are also harmed by the minimum wage. "In the United States," Thomas Sowell pointed out, "the last year in which the black unemployment rate was lower than the white unemployment rate — 1930 — was also the last year when there was no federal minimum wage law." The next year saw the passage of the Davis-Bacon Act, which required workers on federal projects to be paid the local prevailing wage for their jobs. By its supporters' own admission, the law was passed in part to prevent blacks who were willing to work for lower wages from taking jobs that would otherwise have gone to whites. As Sowell's remark about the black unemployment rate indicates, it succeeded.

The current unemployment rate for all teenagers is about 21 percent; for black teenagers, it is about 36 percent. "In 2007, prior to the Great Recession, the black teen unemployment rate was about 29 percent," penned *Forbes'* James Dorn. "There is no doubt the increase in the federal minimum wage from $5.15 to $7.25 per hour contributed to the higher unemployment rate. If Congress passes a new minimum wage law … we can expect further erosion of the market for unskilled workers, especially black teens."

The Obama administration claims that raising the minimum wage is "especially important for women." But according to the Employment Policies Institute (EPI), "Women would actually be disproportionately *harmed* by the President's minimum wage proposal." (Emphasis in original.) The administration based its assertion on the number of jobs held by women that will be covered by the proposal, under the assumption that everyone covered by the higher minimum wage will actually retain his or her job. EPI, however, found that 57 percent of the jobs the CBO projects will be lost under a minimum wage hike are held by women.

Minimum wage increases have other ill effects besides reducing employment for unskilled workers. A 1995 review of 50 years' worth of research on the minimum wage for Congress' Joint Economic Committee on Taxation concluded that, among other things, minimum wage hikes also increase job turnover, discourage part-time work, reduce school attendance, drive up teenage crime rates (because of higher teen unemployment), and encourage employers to hire illegal aliens. Other studies have found that increased minimum wages can lead to smaller raises for employees already making above the minimum as employers try to offset the additional costs. Then there is the ever-popular method of passing the increased costs on to consumers. Wilson cited studies finding that “a 10 percent increase in the U.S. minimum wage raises food prices by up to 4 percent and overall prices by up to 0.4 percent” and “restaurant prices unambiguously increase in response to minimum wage increases.”

Don’t Be Cowed by This Bull, Either

The evidence that the minimum wage causes unemployment is so overwhelming that most proponents of raising the wage don’t even bother disputing it. Instead, they turn to other false arguments to bolster their case.

Chief among these is the assertion that increasing the minimum wage will reduce poverty. For instance, when the Senate failed to overcome a GOP filibuster to pass a minimum wage hike on April 30, Obama charged Republicans with “[saying] no to helping millions work their way out of poverty.”

“However,” wrote Wilson, “evidence from a large number of academic studies suggests that minimum wage increases don’t reduce poverty levels. Some of the reasons include:

Many poor Americans (63.5%) do not work, and thus aren’t earning wages.

Even among the working poor, the relationship between earning a low hourly wage rate and living in poverty is weak and has become weaker over time. That is because most workers who gain from a minimum wage increase live in nonpoor families and most of the working poor already have wages above the required minimums.

While an increase in the minimum wage will lift some families out of poverty, other low-skilled workers may lose their jobs, which reduces their income and drops their families into poverty.

If a minimum wage is partly or fully passed through to consumers in the form of higher prices, it will hurt the poor because they disproportionately suffer from price inflation.

Furthermore, Wilson stated, “the popular belief that minimum wage workers are poor adults (25 years old or older), working full time and trying to raise a family is largely untrue. Just 4.7 percent match that description.” About half of minimum wage earners are teenagers or young adults, and most of them come from non-poor families. Moreover, the minimum wage is generally only paid to those in entry-level jobs; almost two-thirds of minimum wage workers get a raise within their first year on the job.

It would be bad enough if boosting the minimum wage had no effect on poverty levels. But a 2005 review of the evidence by David Neumark, Mark Schweitzer, and William Wascher actually concluded that “the net effect of higher minimum wages is ... to *increase* the proportion of families that are poor and near-poor.” (Emphasis added.) That should not come as a surprise since, as we have already seen, mandating higher wages throws people out of work.

To compound matters, the increased labor costs for nonprofits tend to shrink the resources they have available to help the poor. The Seattle Human Services Coalition, which supported the recently passed incremental increase of the local minimum wage to $15 per hour, had surveyed local nonprofits and found that “21 out of 29 organizations report that without cost offset funds they would be forced to reduce services or close their doors” if the minimum wage rose that high. “The programs most vulnerable to cuts in this case,” the group added, “are those serving the poorest people.”

The claim that hiking the minimum wage would stimulate the economy is even more ludicrous. In a free market, an individual gets a raise because he has become more productive; his increased pay comes from the greater wealth he is generating. But when the raise is mandated by the government, no new wealth is created to cover that cost; it is simply extracted by force from the individual’s employer — and, in turn, from his customers, who now have less money to spend elsewhere. In other words, it’s wealth transfer, not economic growth.

Other Objections

Clearly, increasing the minimum wage will have many baleful effects. Even if it did not, however, there are other good reasons to object to it.

To begin with, mandating a minimum wage of any amount interferes with the right of contract. If an individual agrees to work for an employer for $5 an hour, why should he be forbidden to do so simply because some people think he shouldn’t be paid less than $7.25 (or $10.10) an hour? If he isn’t worth $7.25 an hour to a prospective employer, he won’t be hired, and his income will be zero. He will be worse off, and under the present welfare state, taxpayers will be worse off as well because they will then have to pay for his upkeep.

Also, Supreme Court rulings notwithstanding, a federal minimum wage is plainly unconstitutional. Nothing in the Constitution grants Washington the authority to determine the wages of private-sector employees.

But even if one accepts that a federal minimum wage is constitutional, it is virtually certain that Obama’s executive order raising the minimum wage for federal contractors to $10.10 per hour is not.

“Nothing in the Constitution grants the president authority to set or raise the minimum wage independently of an act of Congress,” *National Review’s* Peter Kirsanow asserted. “Furthermore, although the president generally has authority to improve the efficient discharge of federal contracts, the president’s minimum wage order is incompatible with the expressed and implied will of Congress” as made “abundantly clear in four separate statutes.”

Obama seemed to understand this as recently as December. At that time, he was already under pressure from the Congressional Progressive Caucus to issue an executive order increasing the minimum wage for federal contractors. When asked whether the president would comply with the request, “White House Press Secretary Jay Carney issued a lukewarm response,” according to GovExec.com.

“This has always been done legislatively,” Carney said, “and it has been done with support from Republicans and not just Democrats in the past.”

What happened over the next two months to change Obama’s mind? The most likely explanation is politics. This is an election year, and Democrats are fighting to maintain control of the Senate. If you’re Obama, throwing some bones to your party’s base can’t hurt — even if those bones have been stripped almost bare.

The order, after all, only applies to future contracts. “As a result,” wrote Fox News, “the order would benefit far fewer workers than the number foreseen by advocates of federal contract employees.”

What’s more, the order contains numerous qualifiers to the effect that it must be implemented in a manner consistent with existing law. “If the order is so implemented, most of it will be rendered a nullity, for its substantive provisions directly conflict with applicable law,” Kirsanow maintained. “The result is an order that is unconstitutional and/or a charade.”

Three P’s in the Minimum Wage Pod

With so many negatives associated with increasing the minimum wage, why do many people stump for it nonetheless? The answers are politics, profit, and public relations.

“In the political arena,” columnist Walter Williams observed, “one dumps on people who can’t dump back on him.” Those harmed by the minimum wage the most are teenagers and “poorly educated blacks and Latinos,” who “do not know why they suffer high unemployment” and are not organized, he explained. Meanwhile, the people who do benefit — primarily unions that represent skilled laborers — “are highly organized, and they do have the necessary political clout to get Congress to price their low-skilled competition out of the market so they can demand higher wages,” Williams wrote.

Union employees aren’t the only ones to benefit from an increased minimum wage. Their employers may also benefit because the higher minimum wage will reduce the competitive edge held by their competitors who hire non-union workers. Even non-union employers stand to gain if they happen to pay higher wages, whether it’s their practice or they are forced to do so because of the high cost of living in their areas or higher state or local minimum wages. Walmart, for example, is a vocal advocate of hiking the minimum wage because it already pays more than the minimum and will therefore profit if its competitors are forced to pay higher wages and raise their prices. Companies who produce equipment to do the jobs of unskilled workers also make out when the minimum wage goes up because the more unskilled labor costs, the more attractive replacing it with machines becomes.

Of course, everyone who publicly supports raising the minimum wage claims to be doing so out of compassion for the poor in hopes that this seeming altruism will improve the public’s perception of him or his company or organization. “But,” noted Galles, “it may frequently be a false compassion whose common denominator is advancing one’s own self-interest while harming working families.”

What, then, would real compassion for the poor look like? “The best antipoverty program is not the minimum wage but economic freedom that expands workers’ choices and allows entrepreneurs to freely hire labor without the government dictating the terms of the exchange, except to prevent fraud or violence,” wrote Dorn.

“Economic growth, not price fixing in the form of a federally mandated minimum wage, is the only path to prosperity,” he opined in another article. “Economic freedom and limited government are paramount in the process of wealth creation through mutually beneficial market exchanges.”

And the best part is that they’re constitutional.