Would minimum wage hike mean lost jobs?

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With Congress set to vote on an increase in the minimum wage, Nicholas in Pennsylvania is afraid the increase may end up eliminating low-wage jobs held by the very people the law is trying to help. Keith in Kentucky wants to know just what causes the rapidly expanding U.S. trade imbalance.

It seems to me that raising the minimum wage to $7.25 an hour come January is a good thing. But what about when businesses, who may pay many employees roughly $6 (an hour) or less, suddenly are forced to raise their overhead by more than 17 percent? Would that not force a massive amount of job cuts in the restaurant, retail and hotel industries, where most of those jobs we made in November actually came from?
-- Nicholas S., Chambersburg, Penn.

The debate over the impact of the minimum wage rests on a fertile body of economic research — much of which is contradictory. And that has brought us to the current you-show-my-your-study-and-I'll-show-you-mine political debate.

The current federal minimum wage is $5.15 an hour. Based on a 40-hour week, that comes to less than $11,000 a year. The proposed increase, to $7.25 an hour, works out to about $15,000 a year.

So the increased cost to employers is real. The question — as it has been since [the Fair Labor Standards Act of 1938] set the first U.S. minimum wage at 25 cents an hour — is whether that higher cost will destroy some low-wage jobs.

The impact of the proposed increase will be somewhat muted by laws already enacted by more than half the states calling for minimums above the federal level. Your math, by the way, overstates the impact; though the proposed new federal minimum would represent a 41 increase, the overall impact on business "overhead" would be less (assuming no change in the cost of rent, utilities, raw materials, advertising, etc.) because wages are only part of the picture.

There is certainly a case to be made that the added cost of a higher minimum wage — by itself — could wipe out some marginally profitable businesses and eliminate the jobs they provide. The economics have been spelled out clearly by think tanks like the Cato Institute.

"If the government coercively raises the price of some good (such as labor) above its market value, the demand for that good will fall, and some of the supply will become 'disemployed,'" according to a study by the libertarian group. "Unfortunately, in the case of minimum wages, the disemployed goods are human beings."

To the extent that economists agree on anything, most seem to agree with that theoretical view. A 2000 survey (.pdf file) of members of the American Economic Association found that 46 percent agreed that having a minimum wage raises unemployment among young and unskilled workers, while 28 percent partly agreed, and 27 percent disagreed. (That's down from a 1990 survey in which 62 percent agreed, 19.5 percent partly agreed and 17.5 disagreed.)

But there's always plenty of disagreement in the ivory towers inhabited by labor economists. A widely cited study by two Princeton University professors looked at the real-world impact of a 1992 increase in New Jersey's minimum wage and found little or no impact on the labor markets. The study was promptly attacked by contradictory studies by economists and think tanks with opposing points of view.

But even if one side of this theoretical argument is right, real-world labor markets governed by emotional human beings and regulated by imperfect laws don't always behave the way the economists expect them to.

If Congress does raise the minimum wage, for example, it may also provide some tax relief to small businesses hit hardest by the law. In any case, the minimum wage law probably won't apply to all workers: The current law, for example, exempts many businesses with less than $500,000 a year in revenue. There's also something called a "youth sub-minimum wage" of $4.25 an hour for newly hired employees under age 20 during their first three months of work.

And estimated 14 million workers, or 10 percent of the U.S. workforce currently making less than $7.25 an hour, would see pay increases from the move. And some economists expect that an increase in the minimum wage could bump up wages for others at the lowest rungs of the pay scale.

What if you're one of those 10-million minimum-wage workers? Even then, the evidence that your job is at risk is the subject of spirited debate. Supporters of the minimum wage law, like the Economic Policy Institute, argue that economic theory often does a lousy job of describing what actually happens in the world of low-wage employment. In a briefing paper on the subject, they argue that the labor market doesn't operate efficiently enough to fairly price the value of low-wage work. And higher wages paid by employers may be offset somewhat by the savings they get from lower labor turnover, which means less money spent on rehiring and retraining.

In any case, it looks like the increase is going to be enacted. One big reason is that, since the minimum wage was last raised in 1997, Congress has seen fit to raise its own wages eight times, or 24 percent, to $165,000 a year. (That works out to nearly $80 an hour for a 40-hour week.) With many American families struggling to make ends meet, members of Congress who vote against the increase may see a negative impact on their own employment.