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The Minimum Wage Typifies Much That Is Wrong With Washington

By: Doug Bandow – April 1, 2013

President Barack Obama wants to give low-wage Americans a raise. Actually, he doesn't plan on writing anyone a check. Rather, he wants to force other people to write checks.

It's a bad idea, no matter how popular.

In his State of the Union speech President Obama argued: "no one who works full-time should have to live in poverty." He proposed hiking the minimum wage to $9.00 an hour, a 24 percent jump, which "would raise the incomes of millions of working families." (Other Democrats have advocated $10.10 per hour.)

The president suggested that employers, too, would benefit: "For businesses across the country, it would mean customers with more money in their pockets." Venture capitalist Nick Hanauer was even more fulsome. He advocated more than doubling the minimum, to $15 per hour, which, he contended, would "stimulate the economy, narrow the gap between rich and poor, and end the ridiculous subsidization of private low-wage companies by taxpayers."

It would be the ultimate free lunch.

But if government can make the poor rich, enhance consumer demand, boost the economy, and heal the human spirit, why stop at $9 an hour? Why not set the minimum at $90 per hour? Or $900 per hour? The difference between $9 and $900 is one of degree, not kind.

Alas, profit-making companies must earn more than they spend. Workers must produce more than they are paid. As government raises the minimum wage, it prices some employees out of the market. Mark Wilson of Applied Economic Strategies warned in a Cato Institute study: "These behavioral responses usually offset the positive labor market results that policymakers are hoping for."

The bulk of economic studies—"most of the academic evidence," as Wilson put it—demonstrate that raising the minimum wage destroys jobs. He explained: "The main finding of economic theory and empirical research over the past 70 years is that minimum wage increases tend to reduce employment." The only question is how much.

The Department of Labor concluded that the first minimum wage, 25 cents per hour in 1938, cost the jobs of 30,000 to 50,000 of the 300,000 workers who were covered and had previously earned below the minimum. In following years, noted Wilson, "economists began to accumulate statistical evidence on the effects" of minimum wage increases, which found a disproportionate impact on lower-skilled workers.

In 1977 Congress established the Minimum Wage Study Commission. The panel concluded that the "time-series studies typically find that a ten percent increase in the minimum wage reduces teenage employment by one to three percent." Similar were the results of more recent research. Observed businessman Brandon Crocker, "most studies of previous [pre-1996] rate hikes (such as 1990-1991) show clear evidence of job losses."

A 2007 review 102 studies starting in the 1990s by David Neumark and William Wascher found: "although the wide range of estimates is striking, the oft-stated assertion that the new minimum wage research fails to support the traditional view that the minimum wage reduces the employment of low-wage workers is clearly incorrect. Indeed … the preponderance of the evidence points to disemployment effects." Studies which did not do so were more likely to be industry specific and short-term, which may have influenced the results.

Still, Neumark's and Wascher's conclusion has been criticized. Earlier this year economist John Schmitt made his own literature review and contended that "The weight of that evidence points to little or no employment response to modest increases in the minimum wage."

The best argument for a small disincentive impact is that the present minimum is below the prevailing market wage for most workers. James Sherk of the Heritage Foundation pointed out that in 2011 and 2012 only 2.9 percent of all workers earned the minimum, and that figure included service workers who earned enough in tips to move them above the minimum. Just .6 percent of full-time workers and 1.7 percent of full-time hourly workers earn the minimum. Even 77.2 percent of teens earn more than the minimum. Explained Wilson: "The higher the minimum wage relative to competitive-market wage levels, the greater the employment loss that occurs."

Minimum wage fans largely ignored the academic literature until two decades ago when economists David Card and Alan Krueger—now the President's Chairman of the Council of Economic Advisers—concluded that a recent increase had not destroyed jobs or hurt teen workers. However, the rise studied was modest. Noted Crocker: "One reason why some have found the data from the 1996-1997 more ambiguous is that the minimum wage lagged behind inflation and real wage growth."

Even Card recently admitted: "Of course, if the minimum was raised really high—and enforced—it would likely be a problem. But at reasonable levels the minimum has negligible effects on overall employment." However, the more modest the increase, the less likely that it will produce the benefits claimed for it.

Moreover, the Card/Krueger study has come under sustained fire. Economist Benjamin Powell called it "an outlier, not the norm." Economists Donald Deere, Kevin Murphy, and Finis Welch concluded that "The conventional wisdom remains intact" and "Higher minimum wages go hand-in-hand with substantial declines in the employment of low-productivity workers."

Economist Thomas Sowell warned that the survey technique used by Card and Krueger might miss firms that go out of business, creating "as false a conclusion as interviewing people who have played Russian Roulette." Neumark and Wascher revisited the issue in

2000 using payroll records rather than telephone surveys and reported that the results were “generally consistent with the prediction that raising the minimum wage reduces the demand for low-wage workers.”

Helpful would be detailed research on the latest phase of the multi-year increase starting in 2009. Argued Crocker: “Certainly, the raw data is not encouraging. Whereas the number of employed people in the U.S. fell by about 4.6 percent from July 2008 to July 2010, for teenage workers (a reasonable proxy for minimum wage workers), employment fell by a whopping 21 percent.”

What is certain is that when jobs disappear those with the least education, training, skills, and experience suffer the most. This means younger and minority workers. For instance, a 1973 study by economist Douglas K. Adie concluded that a ten percent increase in the real, inflate-adjusted minimum wage increased teen unemployment by 3.62 percent.

Wilson pointed to early evidence of “adverse effects on the employment opportunities of low-skilled workers” and in “poorer and lower-wage regions.” The minimum wage is a major reason for the persistent gap between unemployment rates for black and white teens and young adults. Although the economy grew during the 1990s, wrote Wilson, “when we look at the employment rate for teenagers, it is a different story. Even in the rapidly growing economy in the last 1990s, the employment rate for teenagers was quite flat, and then it fell during the 2000s.”

Economists William Even and David Macpherson concluded of the 2005-2007 increase: “the consequences of the minimum wage for black young adults without a diploma were actually worse than the consequences of the Great Depression.” After the July 2009 increase, contended economist William Dunkelberg, “nearly 600,000 teen jobs disappeared, even with nearly four percent growth in the economy,” which “compared to a loss of 250,000 jobs in the first half of the year as GDP growth declined by four percent.” Last year the unemployment rate for teens was 24.9 percent and for minority teens was 38.2 percent.

The minimum wage also encourages companies to automate. Observed Richard Berman, executive director of the Center for Union Facts, “Minimum wage increases rapidly accelerate the rate at which technological innovations replace entry-level jobs. Employers are constantly trying to manage with higher labor costs while keeping prices in check.”

Another option is to switch to fewer higher skilled, more productive workers who are worth the higher wage. A 2011 study by the German Institute for the Study of Labor found that in response to a wage hike restaurant managers “express interest in hiring more experienced and older workers.” Labor unions support the minimum wage because it increases demand for their members. Explained Nobel Laureate Gary Becker, higher minimums “reduce the competition faced by union members from the largely non-union workers.”

Minimum wage advocates argue that paying more lowers labor turnover. Probably so, but only employers can decide if the higher cost is worth the benefit. Moreover, noted economist Christina Romer, who formerly chaired President Obama’s Council of Economic Advisers, “If these new workers are typically more affluent—perhaps middle-income spouses or retirees—and end up taking some jobs held by poor workers, a higher minimum could harm the truly disadvantaged.”

Another adjustment, depending on market conditions, is higher prices. Wilson noted: "These results help to reconcile the few minimum wage studies that do not find negative employment effects with the large majority of studies that do." Some companies are able to build higher pay into their cost basis.

A score of studies have found a modest impact on prices—an average of .4 percent for every ten percent rise in the minimum. Restaurants appear to be particularly prone to such increases. A 2011 study found that price hikes in this industry were more common than employment cuts, accounting for roughly two-thirds of the cost increase.

Price hikes can claw back wage gains. Said Romer: "Often, the customers paying those prices—including some of the diners at McDonald's and the shoppers at Walmart—have very low family incomes. Thus this price effect may harm the very people whom a minimum wage is supposed to help."

Companies look for other ways to adapt as well. Exact results vary by market, industry, and company. For instance, the Institute for the Study of Labor reviewed the experience of Alabama and Georgia restaurants. The Institute found: "Cost increases were instead absorbed through other channels of adjustment, including higher prices, lower profit margins, wage compression, reduced turnover, and higher performance standards."

A 2011 economic study found that some employers responded by reducing pay raises for other workers. In addition, explained Wilson: "Some firms try to increase worker productivity by requiring better attendance, insisting that job duties are completed faster, imposing additional tasks on workers, minimizing hours worked with better scheduling, and terminating poor performers more quickly." The Joint Economic Committee pointed to longer periods of unemployment for low-wage workers; more workers pushed into uncovered, lower-wage jobs; reduced fringe benefits and training; and greater reliance on illegal aliens.

Unfortunately, a rising minimum does not exist in isolation. The Congressional Budget Office figured that the new mandated health care benefit package alone will add $4,750-individual/$12,250-family policy per employee costs, or $2.28/$5.89 per hour. Warned Philip Klein of the *Washington Examiner*: "Already, fast-food and chain restaurants have been announcing plans to cut back worker hours to avoid the federal penalty for not providing government-approved health insurance. To them, an increase in the minimum wage on top of the health care mandate would be another incentive to cut back on their workforce."

When confronted with evidence that the minimum wage harms workers, some advocates respond with even more extravagant claims. For instance, Jack Temple of the National Employment Law Project insisted that a minimum wage hike "boosts consumer spending" and thus would "have a significant stimulus on the economy." The *Financial Times* editorialized: "a higher wage would stimulate the economy without adding a dime to federal spending."

However, the increased pay comes from someone—owners, consumers, other workers—who will have less money to spend. The poor have a greater propensity to spend (rather than save), so, runs the argument, redistributing income still would boost the economy. However, Romer warned that the resulting effect would be small, at most maybe a tenth of a percent of the GDP. And minimum wage recipients would suffer disproportionately from any price increases.

The minimum wage is no weapon against poverty. Explained Wilson: "Since 1995, eight studies have examined the income and poverty effects of minimum wage increases, and all but one have found that past minimum wage hikes had no effect on poverty."

The president declared that it was "wrong" that a family attempting to live on the minimum wage falls below the poverty line. However, just 11.3 percent of minimum wage workers live in a poor household. The average income of families with minimum wage workers is above $53,000, more than twice the poverty line for a family of four. Nearly two-thirds of recipients live in homes with incomes at least twice the poverty line. Just 16.8 percent of teen minimum wage workers live in homes below the poverty line.

Only .66 percent of full-time workers and 1.7 percent of full-time hourly wage employees earn the minimum. Just four percent of minimum wage earners are heads of households working full-time attempting to raise a family, *less than the percentage for all workers*. Most employees collecting the minimum are teens or young adults or are working part-time. As a result, a 2007 study by the Congressional Budget Office figured that just one-seventh of minimum wage increases went to employees in poor families.

Moreover, poverty is not eased if people lose their jobs.

Ultimately, a growing economy is the best friend of low-wage workers. Crocker pointed out that the percentage of the workforce earning the minimum dropped from 6.7 percent in 1997 to 2.2 percent in 2006.

Some minimum wage advocates view low wage jobs as immoral. However, there is no alternative for those with little education, training, and experience. Moreover, even with low pay such work may teach basic responsibilities and skills, yielding higher wages in the future.

Gary Burtless, a Brookings Institution economist, said a hike would be "good to do for fairness." Similarly, Rep. George Miller (D-Cal.) argued that "the American public knows that it's very unfair for people working for low wages who can't support themselves."

But what is fair about forcing *other people* to pay above market wages? At least John Cassidy was forthright in the *New Yorker*: "In the current political environment, there is little chance of pushing through another hike in income-support programs. Raising the minimum wage pushes the burden onto corporations and consumers." It would be better if those campaigning for a higher minimum paid the extra cost.

At least the burden should be shared. The Earned Income Tax Credit makes all taxpayers pay. The EITC is expensive and suffers from widespread fraud. Nevertheless, noted *Washington Post* columnist Charles Lane, it is more appropriate to promote poverty relief "through a transparent tax-code subsidy that falls on the public as a whole—rather than the minimum wage, which works like an invisible tax businesses passed along to workers and consumers."

The minimum wage typifies what is wrong with Washington. Raising the minimum wage would be both counterproductive and unfair. It is time to bury this destructive economic panacea.