Another View: 'Zombie economics' color minimum wage talk

By: James A. Donn – March 2, 2013

President Obama's proposal to increase the federal minimum wage is a case of what Nobel laureate economist Paul Krugman calls "zombie economic ideas." According to Krugman, "a zombie idea is a proposition that has been thoroughly refuted by analysis and evidence, and should be dead — but won't stay dead because it serves a political purpose, appeals to prejudices, or both." In his New York Times column, "Rubio and the Zombies," Krugman does not attack the minimum wage, but he should.

A fundamental law of economics — the law of demand — states that when the price of anything (including labor) increases, the quantity demanded will decrease, assuming other things affecting demand remain unchanged. In the case of labor, this means as the price of labor (the wage rate) increases, the number of jobs will decrease, other things constant. Moreover, the decrease in employment will be greater in the long run as employers shift to labor-saving methods of production.

Public policy should be based on sound economics, not on politically popular myths.

Numerous studies have shown that when the real minimum wage is pushed above the prevailing market wage for unskilled workers, jobs are lost and others never created. The government can promise a higher wage rate, but if a worker loses her job, her income will be zero.

President Obama is practicing zombie economics when he ignores the law of demand and promises to raise the federal minimum wage from $7.25 an hour to $9, so that "no one who works full-time should have to live in poverty." He believes that "this single step would raise the incomes of millions of working families." If so, why not increase the federal minimum to $100 an hour and abolish poverty?

Earlier work by Princeton economists David Card and Alan Krueger (now the chairman of President Obama's Council of Economic Advisers) purported to show that modest increases in the minimum wage don't necessarily decrease employment and may even have a positive impact on jobs for low-skilled workers. Their use of survey data, however, was seriously flawed, and their results were refuted by University of California at Irvine economist David Neumark and others.

In an article in Cato's Regulation magazine in 1995, Donald Deere, Kevin Murphy, and Finis Welch carefully examined the Card-Krueger case studies and concluded: "Higher minimum wages go hand-in-hand with substantial declines in the employment of low-productivity workers. ... The conventional wisdom remains intact."

In addition to the negative impact of the minimum wage on employment (i.e., the number of jobs or the quantity demanded of labor), a rise in the minimum wage tends to draw workers into the job market (i.e., increase the quantity supplied of labor). But those new entrants will not be able to find jobs at the above-market wage rate. The result will be an increase in the unemployment rate for low-skilled workers, especially teens and minorities — and the unemployment will be greater in the long run than in the short run.

Even though President Obama promises jobs to low-skilled workers, there will be many disappointed workers who won't be able to find a full-time job or any job at the legal minimum, if the federal real minimum wage exceeds the market wage.

Labor economist Douglas Adie, in an important study of "Teen-Age Unemployment and Real Federal Minimum Wages" (Journal of Political Economy, 1973), found that a 10 percent increase in the federal real minimum wage increases the unemployment rate for teens by 3.6 percent. That effect is greater in the long run as employers change their production methods to save on the higher-priced labor and is more pronounced for minorities.

If Congress increased the minimum wage to $9 an hour, a 24 percent rise in the price of unskilled labor, and indexed it, one could predict with a high degree of confidence that the unemployment rate for teens, especially minorities, would rise unless there were offsetting forces to increase the demand for low-skilled workers.

The way to create jobs and increase one's real wage rate is not to increase the minimum wage, but to increase one's productivity. Forcing employers to pay a worker $9 an hour when that worker produces only $7 an hour is a recipe for failure and poverty. Enacting a higher minimum wage does not guarantee a job or a higher income for all workers — only those who retain their jobs at the expense of those who lose their jobs or can't find a job at the above-market wage.

Economic growth, not price fixing in the form of a federally mandated minimum wage, is the only path to prosperity. Economic freedom and limited government are paramount in the process of wealth creation through mutually beneficial market exchanges. President Obama, in his State of the Union address, called for government to encourage "free enterprise." That objective is not served by denying low-skilled workers the opportunity to get a job, increase their human capital, and move to higher paying jobs as they acquire experience and training.

The minimum wage has the most serious impact on the least productive workers who are likely from poor families. Increasing wage rates by government fiat is not a solution to the problem of poverty. Increasing economic freedom so people can lift themselves out of poverty is a better alternative to zombie economics.

The United States needs to abolish the minimum wage, not increase it. Workers who are willing to work at free-market wages should have the right to do so, and employers should have the right to hire them. Government should get out of the way and let markets work.