

# Bloomberg

## Free-Lunch Debate Reignites as Obama Touts Higher Minimum Wage

By Lorraine Woellert and Victoria Stilwell January 30, 2014

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The debate over President Barack Obama's proposal to raise the minimum wage turns on the credibility of an economic tenet popularized by Milton Friedman: "There's no such thing as a free lunch."

Since states began raising their wage floors two decades ago, economists have focused on the patchwork of laws in a debate about the impact -- or lack thereof. Some studies argue that moderate increases have little or no ill effects on hiring and therefore will boost household income and spending. Others call the laws job killers that hurt unskilled and low-paid workers, the very people they're meant to help.

The sides square off again as Obama and other Democrats push for an increase in the \$7.25-an-hour federal minimum. In his annual State of the Union address this week, Obama announced a wage increase for the lowest-paid federal workers and contract employees, and prodded state and city governments to take similar action if Congress doesn't.

"To every mayor, governor, state legislator in America, I say, you don't have to wait for Congress to act," Obama said. "Join the rest of the country. Say yes. Give America a raise."

The subjects of the discourse are the lowest-paid Americans. While they would benefit from a pay raise, the trade-off could be fewer jobs, shorter workweeks and less incentive to acquire skills and get better positions, say analysts such as John Silvia.

"There is no free lunch," said Silvia, chief economist at Wells Fargo Securities LLC in Charlotte, North Carolina, and a former chief economist of the Senate Banking Committee under Texas

Republican Phil Gramm, channeling Friedman. “The money has to come from somewhere, and that’s the big problem.”

## **Wage Advocates**

Others, including Alan Krueger and Arindrajit Dube, challenge the supply-and-demand principle that higher wages lead to fewer jobs. Raising entry-level pay to \$10.10 an hour, the target sought by Democrats, would lift millions of workers out of poverty, lower employee turnover, boost consumer spending and inflict minimal pain on the economy, they say.

The economic duel took off in 1994 with a paper from Krueger, currently an economics professor at Princeton University in New Jersey and a former economic adviser to Obama, and David Card, now director of the Labor Studies Program at the National Bureau of Economic Research. They compared employment at fast-food eateries in New Jersey and Pennsylvania after New Jersey raised its hourly minimum wage to \$5.05 from \$4.25 in 1992.

## **More Employment**

“The increase in the minimum wage increased employment,” the two found. Job prospects even improved for low-wage workers in New Jersey, they concluded. This month, that state raised its minimum to \$8.25 an hour.

The surprising finding was both widely hailed and criticized. And it handed a talking point to politicians on both sides of the aisle.

Conservatives and libertarians latched on to Friedman’s free lunch. A famed free-market economist and Nobel laureate, Friedman advocated minimal government intervention in markets, and said every action had an explicit or implicit cost. Democrats and their allies pointed to examples of places where minimum wage laws had little obvious adverse impact.

In 2004, San Francisco became the first municipality to set its own minimum wage, increasing it to \$8.50. A 2007 study led by Dube, an economist at the University of Massachusetts at Amherst, compared restaurants in the city and the adjacent East Bay before and after the increase. The researchers found no significant effects on employment or hours worked.

## **Little Influence**

Dube said so few people earn the minimum that the macroeconomic impact is minimal.

“For moderate increases in minimum wage, the earnings increase fairly substantially at the bottom with fairly small effects on employment,” Dube said in an interview. “Good or bad, you wouldn’t expect to see the effects of minimum wage on overall unemployment or overall inflation.”

San Francisco Mayor Ed Lee is sold. Lee, a Democrat who sat with First Lady Michelle Obama during last night's speech, wants to boost the city minimum wage to \$15 an hour from the current \$10.55.

Work from Krueger and Dube has been answered by David Neumark, an economist at the University of California at Irvine, and Federal Reserve economist William Wascher.

The evidence shows that increasing the minimum wage hurts low-paid workers, Neumark said. The trade-offs, including higher prices by companies trying to make up the added expense, aren't worth the benefits, he said.

## **Costs, Benefits**

"The most honest folks acknowledge there is some job loss, but suggest that other potential benefits more than compensate for this," Neumark said in an e-mail. "The debate should be about whether there are benefits that potentially offset the unemployment effects, and whether there are better ways to deliver those benefits."

Analysts at the Cato Institute in Washington, which supports limited government, found that just 4.7 percent of minimum-wage workers are poor adults. Many live in families with incomes above the poverty level, they said.

"It has a very limited impact on poverty," said Michael Tanner, a senior fellow at Cato.

To its supporters, that isn't important.

"There are a lot of reasons why we should care about the earnings of low-wage workers beyond simply as an anti-poverty strategy," said Melissa Kearney, director of the Hamilton Project at the Brookings Institution in Washington. "There's something to be said for supporting low-wage workers even if they're not below the poverty line."

## **Political Debate**

Politicians have joined the debate as they prepare for congressional elections in November. Five years into the economic recovery, the unemployment rate at 6.7 percent remains almost two percentage points higher than when the recession began in December 2007. Some evidence suggests that many of the long-term unemployed have abandoned the job search altogether. The gap between rich and poor is widening and Obama has made redressing inequality a centerpiece of his domestic agenda.

The federal minimum wage doesn't buy what it used to. When Congress first established it in 1938, it was 25 cents an hour. Since then, it's been increased 22 times, most recently in July 2009. In the interim, its buying power has fluctuated, according to a Jan. 8 study from the Congressional Research Service.

That 25 cents in 1938 would be worth \$4.06 today, according to the report. Adjusted for inflation, the value of the wage peaked in February 1968, when the then \$1.60 rate was worth \$10.69, about 47 percent higher than the current \$7.25 an hour.

## **At Minimum**

As of January, 21 states and the District of Columbia have a higher floor. Brookings estimates only 2.6 percent of American workers actually earn the local, state or federal minimum.

Brookings' Kearney said the potential ripple effects of a higher minimum are much broader. Almost 30 percent of employees, as many as 35 million workers, earn 150 percent of the minimum in their state. Those workers also are likely to see a boost in pay, she said.

“If you have the lowest-paid workers in your staff making a certain amount, and then you bump them up, you don't want to change where people are on your wage ladder, so people get bumped up,” Kearney said in an interview. “We can't dismiss this policy lever as being essentially irrelevant just because not so many people make exactly that amount.”

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