MINIMUM SEN$E

By Donald Deere

With the changing of the guard in Congress, the federal minimum wage seems all set to rise from the current $5.15/hour to $7.25. Making workers more valuable to their employers is a great idea – but an increase in the minimum wage only makes them more expensive.

The minimum wage is the amount that someone must be able to earn in order to get or keep a job. The minimum is not how much a worker is worth, but how much they cost. Employers are not in the business of paying more for labor, or anything else for that matter, than it's worth to their company. An increase in the cost of labor – and that is all that a minimum wage increase is – will reduce employment opportunities.

Of course, a "modest" increase in the minimum will not affect most workers (because they make well above the minimum wage in any case), hence there is little danger the $7.25 minimum wage will take the economy into recession. But raising the minimum will make it more difficult for the lowest paid (i.e., the least-skilled) workers to remain employed. Although a little bit of poison may not kill you, that is hardly a reason for taking it.

More is Less — Higher Cost and Reduced Employment

Minimum wage laws focus on wages, not employment; if someone is employed, then he will receive at least the guaranteed wage. The law sets the terms of whatever employment happens to occur. The reduction in employment that results from increases in the minimum wage, which is concentrated among those workers with the fewest skills, is the cruel "dark side" of such legislation.

To understand the perversity of such a law, explore the alternatives available to employee and employer when the minimum wage is increased. The employee's only choice is to find a job where he can earn at least the new minimum or become a non-employee. In contrast, the employer and the consumer, who is the employer's employer, have a broader range of options. The employer can replace low-wage workers with more-productive workers; after all, the vast majority of workers have wages that exceed even the most aggressive proposal for a minimum wage. A second alternative is to outsource, to subcontract activities performed by low-wage employees by going abroad or to self-employed contractors (given the government has as yet been unable to devise a scheme for imposing minimum wages on the self-employed). A third alternative is to automate, to substitute machines that do not have legislated minimum prices. Finally, there is the alternative of just cutting back. If minimum wages accomplish anything, they increase the employer's costs, causing the consumers of his product or service to search for lower priced alternatives. This may include choosing the same products from abroad or switching, in whole or in part, to different products.

As employers explore alternatives to the continued employment of their now more expensive low-skilled workers, they may turn to more-productive workers newly attracted to the labor market by the prospect of higher wages. This substitution of higher quality for lower-quality workers has two important consequences. First, it illustrates again how the minimum wage has its harshest impact on those who are least productive. Second, replacement of lower-skilled workers – such as a 17-year-old replacing a 16-year-old or a young high school graduate taking over for an older high school dropout – is difficult to discern in the data. The substitution of more-productive for less-productive workers causes the observed losses in net employment to understate, perhaps severely, what is happening to the least-skilled workers.

A popular idea among those who favor increasing minimum wages is that firms will respond to an increased minimum by "getting more out of" their employees. But how would this be accomplished? If greater productivity is achieved by substituting higher quality workers, then low-skilled, and thus low-wage, workers take it on the chin. If, on the other hand, the same workers are now working harder, there is still a problem. Work has two dimensions, time on the job and effort at the job. At the previous wage the employer and his employees had reached an understanding about what constituted an hour's worth of work for an hour's pay. They could have reached an agreement on a greater amount of effort per hour and a greater hourly wage. But the fact that they did not suggests that the agreement they did reach was preferred to other potential agreements involving higher wages and greater effort. If low-skilled workers must put forth more effort just to keep their jobs and earn the higher wage, then they have actually taken a step backward. Their earnings have risen, but not by enough to make up for their increased effort. This must be true, otherwise the employer could have been "getting more out of" its workers all along simply by paying the higher wage.

The implications of economic common sense are simple and direct. The prediction that an artificial increase in the price of something causes less of it to be purchased is the most fundamental tenet of economics; it is called the law of demand.

Who is Affected? — Low Wages and Low Skill

The workers making between the current minimum and the proposed $7.25/hour have one thing in common – little skill. As expected, those with the least experience, aka teenagers, are the most likely to make low wages. During 2005, the most recent full-year of data available, 40 percent of teens made between the current minimum wage (either the federal $5.15 or a higher state-legislated minimum) and $7.25. Also those with the least education were more likely to have low pay – 23 percent of high school dropouts between the ages of 20 and 24 received low wages. About 13 percent of those with a bit more experience or education, older high school dropouts and young (20 to 24) high school graduates, received low wages. These percentages are well above the six percent low-wage rate for all workers.

If it were only teenagers who got more expensive as the minimum wage rose, then it would not matter so much. Teens will (in most cases) see their productivity grow as they do, despite the higher minimum wage making it more difficult to get that first job and the consequent experience. Although teenagers are the group most likely to make low wages, this group comprises only 28 percent of all the workers whose cost will increase as a result of raising the minimum wage to $7.25. Less-educated workers – dropouts and those with no more than a high school diploma – who will see the cost of their employment rise, are a bigger group. These workers will have a harder time increasing their productivity to keep pace with their artificially increased price. This will not be easy. A return to school may be possible. Also, experience can substitute for the lack of education, but, again, the higher the minimum, the more difficult getting that experience will be.

Here is the true tragedy of minimum wages. Beyond teens, those with little education and a now-smaller chance of getting experience to offset their education shortfall are most likely to be "priced out" of a job by a minimum wage increase. Even worse, this "pricing out" is more likely to affect African American and Hispanic minorities and women. Making workers who have fewer skills more expensive to employ is nonsense.

Why? — Higher Incomes vs. Higher Cost

The purported reason for increasing the minimum wage is to assist the working poor. There are two problems here.

First, most low-wage workers are not in low-income households – there are more than twice as many low-wage workers in households with incomes above $75,000 than in households with incomes $20,000 and below. Most of those who earn low wages are either teenagers or other secondary earners spread rather evenly across the income distribution. While the single mother trying to support her child on a full-time minimum wage job is a better story, the teenage hamburger-flipper with college-educated and employed parents is a better fact.

Second of all, most low-income households do not have anyone working – more than 60 percent of households with incomes $20,000 and below do not include an employed resident compared with less than five percent for households with incomes above $75,000. The problem of low incomes is not low wages, but no wages. This comes back to the skill issue – more than 60 percent of households with incomes $20,000 and lower have no resident with education beyond high school. In comparison, less than 12 percent of high income households have no resident with more than a high school degree.

So, minimum wages make workers more expensive, but not more valuable, thereby reducing their employment opportunities – why raise it (or, for that matter, even have it)? From the original legislation establishing a federal minimum wage in 1938, through the 18 additional increases, to the eminent proposed hike, a goal of minimum wage supporters is to raise the cost of cheap labor that threatens higher-priced workers.

Do you think that Northern legislators were interested in the welfare of Southern workers or in protecting the jobs and wages of their constituents when they passed the first minimum wage? Do you think that unions, only a tiny fraction of whose members actually make the minimum wage or close to it, but who always favor an increased minimum wage, are more interested in the welfare of nonunion workers or in raising the cost of hiring nonunion workers?

Past votes in Congress to increase the minimum wage reflect this pursuit of self-interest. Those voting to raise the minimum wage were typically from higher wage states – where the "pricing out" effect of another increase-would have less impact – than were those voting against a higher minimum. It appears easier to cast a vote reducing employment opportunities when the jobs will be lost by someone else's constituents. This pattern continues. Two of the Democrat leaders putting an increase in the minimum wage near the top of the legislative agenda are Nancy Pelosi of California in the House and Edward Kennedy of Massachusetts in the Senate. An increase in the minimum wage to $7.25 will raise the cost of 19 percent of the hourly workers in Texas, compared to 10 percent of California's hourly workers, and to five percent of hourly workers in Massachusetts. This kind of "help", which just makes Texas workers more expensive, we don't need.

Summary

The minimum wage does not prevent everyone from getting any job. Passing a law that makes workers who have fewer skills more expensive, however, only increases the difficulty those who already have a hard time getting a job will face in starting or continuing a career. Put another way, if the minimum wage is indeed a good idea, then why stop at $7.25/hour? Why not $30,000/year? My two teenage sons would love to make this much money. But what would I have them do? **N**

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