THE MINIMUM WAGE: DOES IT REALLY HELP WORKERS?

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ABSTRACT

There is perhaps no greater cognitive dissonance than that which exists between the view that economists and non economists have about the minimum wage law. According to the latter, most recently articulated by President Clinton in an attempt to raise the level of coverage from $5.15 to $6.15, this law is all that stands betwen poorer working Americans and a continued loss in the purchasing power of their salaries. However, as the present paper points out, this is a snare and a delusion. The minimum wage actually creates unemployment for the unskilled. Far from benefitting them, it is a positive harm to those at the bottom of the labor market.

"More and more Americans are working hard without a raise. Congress sets the minimum wage. Within a year the minimum wage will fall to a forty-year low in purchasing power. But millions of Americans and their children are trying to live on it. I challenge you to raise their minimum wage"[1], President Clinton said to Congress in his State of the Union address on January 23, 1996. Yet, does the minimum wage really raise the wages of workers working below the minimum wage? Can wages be legislated? Are most minimum wage workers really struggling to live on the minimum wage? Both economic theory and empirical evidence suggest that the minimum wage does nothing to raise wages and actually increases unemployment, especially among teenagers and minorities.

One of the most widely perpetrated myths is that a wage is different from a price. In fact, no difference exists between wages and prices. Quite simply, a wage is the price of labor that the employees agrees to work for and the employer agrees to pay.[2] Therefore, the laws of supply and demand govern wages, and a minimum wage is nothing more than a price floor which inevitably causes a surplus of labor. At a minimum wage of $4.25 an hour, workers whose productivity is worth $1.00 an hour will most likely be unemployed. Employers who would have hired workers worth $1.00 an hour to do various jobs will now be forced to hire workers at $4.25 an hour for the same jobs, or else the jobs will be eliminated. As Henry Hazlitt states, "You cannot make a man worth a given amount by making it illegal to offer him anything less. You merely deprive him of the right to earn the amount that his abilities and situation would permit him to earn, while you deprive the community even of the moderate services he is capable of rendering. In brief, you substitute a low wage for unemployment."[3]

To exaggerate, consider the effects of a minimum wage of $100,000 a year on the unemployment rate of high school and undergraduate college students. Who would hire many of these workers at that rate of pay? These students do not possess the skills to perform these jobs worth $100,000 a year. Therefore, they will likely all be unemployed.

It is possible that the wages of many workers whose productivity is close to a newly-imposed minimum wage but below that minimum wage will receive a raise in the short run, simply because it will be too costly to fire workers immediately without hiring replacements. However, over time the employees whose productivity was close to the minimum wage will be fired and replaced by either more productive labor or more productive machinery. The unemployment caused by the minimum wage can be disguised, but it cannot be avoided.

Proponents of the minimum wage might say that the substitution of more productive machinery for less productive labor is beneficial, reasoning that technological improvements are always good. But if the technology was really so beneficial, why would it take a new minimum wage law to force the employers to implement the technology? If the employer could profit regardless of a new minimum wage law from the substitution of technology for labor, why not substitute the technology in the first place?[4]

Does the minimum wage always cause unemployment? No. One exception occurs when an employee is earning less than he is worth. However, these situations are quite rare and are better dealt with through the market. [5] For the usual practice is for employees being paid less than their productivity levels would warrant is to seek other jobs at higher remuneration. Alternatively, such workers are likely to become targets for "raiding" competitive employers. If there are such underpaid workers, as there are, say, in Mexico, firms can be counted upon to send trucks and buses there, to scoop up these people, take them to the farms of California and Texas, at higher wages than available at home.

The employer may also compensate for the enactment of minimum wage legislation by taking fringe benefits or other non-wage benefits from the employee by paying the cost of the fringe benefit to the employee in the form of wages.[6] While the employee will not benefit, he may stand to lose much if he values the fringe benefit more than its cost given to him in the form of wages. The resulting surplus of labor from the imposition of the minimum wage will also decrease the incentive of employers to offer fringe benefits and other non-wage benefits. Now the employer has more worker to choose from and thus has the luxury of selectivity.[7]

In any of the above cases, the minimum wage does not in the long run increase the compensation the worker receives for his work. In fact, the minimum wage often harms the workers even if they do manage to keep their jobs. Nevertheless, it is important to note that the workers in the above cases will at first appear to have benefited by an increase in the minimum wage. They will still be employed, and many will assume that their wages or total compensation package will increase in the long run through an increase in the minimum wage. Unfortunately, this is not the case. In short, Congress cannot give people more by legislating a minimum wage. "You cannot make a man worth a given amount by making it illegal for anyone to offer him anything less.[8]

Many advocates of a higher minimum wage argue that the present minimum wage is insufficient to support a family. Besides the fact that the minimum wage law hurts those same families, empirical evidence suggests that the typical minimum wage worker is not supporting a family. "In 1992 less than 10% of the workers earning the minimum wage were heads of families below the poverty level ... Most (62 percent) of the minimum wage workers were employed only part-time. More than one-third were teenagers. The typical minimum wage worker is a spouse or teenage member of a household with an income well above the poverty level. Therefore, even if the adverse impact of a higher minimum wage on both employment and non-wage forms of compensation is ignored, a higher minimum wage will exert little impact on the income of the poor,"[9] says James D. Gwartney and Richard L. Stroup, economists from Florida State University and Montana State University, respectively.

If one wishes to examine empirical evidence of the effects of the minimum wage on employment, teenagers are an important group to study. Besides the fact that teenagers make up a large portion of the workers either having or desiring minimum wage jobs, teenagers also tend to be some of the least skilled and inexperienced workers in the labor force. Minority teenagers are also an important group to study. Latin Americans, have less skill, experience, and education than white teenagers, and consequenty receive less in wages than a white teenager without the minimum wage law. Therefore, the minimum wage will tend to drive blacks and Latin Americans into the ranks of the unemployed to a greater extent than white teenagers.[10]

When considering various statistical evidence on the effects of the minimum wage on the rate of unemployment, it is important to make some key observations. For one, employers are able to compensate for some of the unemployment effects of the minimum wage as seen in some of the cases outlined above. However, the minimum wage exerts other harmful effects besides unemployment when employers are forced to compensate in other ways for the higher price of labor caused by a new minimum wage law. An adverse effect of the minimum wage which is especially harmful to teenagers is the fact that the minimum wage eliminates the chance of teen-agers taking certain low-wage jobs, gaining experience, and eventually obtaining better careers in the future. The minimum wage makes it difficult for employers to afford to give teenagers jobs with training.[11]

Secondly, many teenagers upon having difficulty finding a job will become discouraged and leave the labor force entirely. These workers will not be counted in the ranks of the unemployed, although many would take a job if they were offered one. Lastly, it is important to realize that the minimum wage in the United States does not apply to all jobs.[12] As a result, some low-skill workers will still be able to get jobs in the sector not covered by the minimum wage.

In graphs issued by the Bureau of Labor Statistics, the effects of the minimum wage on various groups are shown. The first graph illustrates the effects of the minimum wage on teenage and non-teenage (adult) males. The first year on the graph is 1948, which is three years after the minimum wage was first raised in 1945 to $.40 an hour. The last year on the graph is 1964. The unemployment rate in 1948 for teenage males was 8%. By 1964, with a minimum wage of $1.25 an hour, the unemployment rate for teenage males was about 13%. Conversely, the unemployment rate fluctuated from about 2% in the 1952-1954 period to a high of 5% in 1958 for adult males. By 1964, the unemployment rate for adult males was below 4%.[13]

On another graph, the unemployment rate for white male teenagers and nonwhite male teenagers is compared to increases in the minimum wage. In 1948, the unemployment rate for both groups was around 8%. By 1964, when the minimum wage was $1.25 an hour, white male teenage unemployment was at 12%, while nonwhite male teenage unemployment was at a whopping 22%-23%.[14]

Perhaps the most interesting minimum wage increase to study is the 1956 increase from $.75 to $1.00 an hour, a 33% increase. Within a few years, the unemployment rate rose for all groups. From 1956-1958, the unemployment rate for adult males rose from less than 4% in 1956 to 5% in 1958, while the aggregate teenage male unemployment rate rose from about 10% to almost 16% in the same period. From 1956-1958, the white male teenage unemployment rate rose from about 10% to around 14%, while nonwhite male teenage unemployment rose from about 13% to a whopping 24% in that period.[15] The majority of the nonwhite teenagers are black. Both Yale Brozen and Milton Friedman deny that discrimination or the migration of blacks from the South to the cities of the North caused a wide gap to emerge between the unemployment rate of white male teenagers and nonwhite male teenagers after the 1956 minimum wage increase. "If (the wage gap) had been caused by increasing prejudice or increasing migration, you would expect a gradual widening of the spread. But it wasn't a gradual widening. It occurred quite suddenly,"[16] said Brozen.

Most studies done on the effects of the minimum wage on unemployment have shown that "a 10 percent increase in the minimum wage reduces teenage unemployment by 1 to 3 percent."[17] The effect of the minimum wage of teenage unemployment is relatively low largely because of its effect of eliminating non-wage compensation such as job training programs.[18] However, most of these studies do not incorporate the period of the 1980s, a unique period in which the minimum wage was only raised once to $3.35 an hour in 1981. Due to inflation, the real value of the minimum wage decreased approximately 20% from 1981-1989. Therefore, the rate of teenage unemployment should have decreased because of the substantial devaluation of the minimum wage. A study by Alison J. Wellington found that if the period of the 1980's was incorporated, a 10% increase in the minimum wage leads to a less than 1% decrease in teenage unemployment.[19]

In short, President Clinton's analysis of the minimum wage is wrong. The minimum wage does not positively affect the long-run earnings of Americans. Neither economic theory nor carefully-scrutinized empirical evidence indicate that this is the case. And, contrary to what the President implies, most minimum wage earners are not supporting families. In fact, the minimum wage for the most part does not help those it intends to help. In reality, the minimum wage causes unemployment and other problems.

ENDNOTES

[1] "Prepared Text for the President's State of the Union Message." *New York Times* 24 Jan. 1996 p. A13.

[2] Henry Hazlitt, *Economics in One Lesson* (New York: Crown Publishers, 1979) p. 134.

[3] Hazlitt p. 135.

[4] Hazlitt p. 29.

[5] Hazlitt p. 135.

[6] Alison J. Wellington, "Effects of the Minimum Wage Law on the Employment Status ofYouths: An Update," *The Journal of Human Resources* vol. 26 (Winter 1991): p. 33.

[7] James D. Gwartney and Richard L. Stroup, *Economics: Private and Public Choice* (New York: Hardcourt Brace and Company, 1995) p. 697.

[8] Hazlitt p. 135.

[9] Gwartney and Stroup p. 697.

[10] Gwartney and Stroup p. 697.

[11] Gwartney and Stroup p. 696.

[12] Wellington p. 30.

[13] Yale Brozen and Milton Friedman, *The Minimum Wage: Who Really Pays?* (Washington, D.C.: The Free Society Association, 1966). p. 15.

[14] Brozen and Friedman p. 12.

[15] Brozen and Friedman p. 12, 15.

[16] Brozen and Friedman p. 13.

[17] Gwartney and Stroup p. 696.

[18] Gwartney and Stroup p. 696.

[19] Wellington p. 27.

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1. Brozen, Yale, and Milton Friedman. *The Minimum Wage Rate: Who Really Pays?* Washington, D.C.: The Free Society Association, Inc., 1966.

2. Gwartney, James D. and Stroup, Richard L. *Economics: Private and Public Choice*. New York: Hardcourt Brace and Company, 1995.

3. Hazlitt, Henry. *Economics in One Lesson*. New York: Crown Publishers, 1979.

4. "Prepared Text for the President's State of the Union Message." *New York Times* 24 Jan. 1996, p. A13.

5. Wellington, Alison J. "Effects of the Minimum Wage Law on the Employment Status ofYouths: An Update." *The Journal of Human Resources* vol. 26 (Winter 1991): pp. 27-46.