Minimum Wage Policy Memo:

Should the minimum wage be raised to $15/hour nationwide?

By Nataniel Moreau

Increasing the minimum wage has the potential to increase earnings for low-wage workers. In this way, the minimum wage can be an effective tool for reducing income inequality and improving the quality of life for low-income households. There are possible drawbacks of increases in the minimum wage such as decreases in employment, but these effects are variable and may disperse over time. Overall, I recommend indexing the minimum wage to the cost of living at the state or county level in place of a flat $15 minimum.

This policy has two main benefits over a flat increase. First, both the positive and negative effects will be consistent across largely variable areas of the United States. A flat increase will likely lead to certain disadvantaged/poor areas bearing large adverse effects stemming from a disproportionate increase relative to their local costs. Similarly, a flat increase may not cover the needs of more affluent areas where costs have risen more acutely. Second, indexing the minimum wage is a future-proof policy that automatically updates itself thus bypassing the need for constant discussion and approval that would be burdensome in both time and money as well as more vulnerable to political sabotage and red tape.

Experiments in multiple places including Seattle, New York, California, and Massachusetts have shown that generally, the positive gains from an increase in the minimum wage are concentrated in increased overall earnings. In Seattle, over a year after the first phase of increases to $15/hr was enacted, there were significant changes in all areas besides employment which tended to be negative. Workers saw reductions in hours worked but not total earnings, implying that wage growth outpaced declines in total employment (Jardim et al). Cengiz et al corroborate these findings on an expanded scale using 138 instances of min wage increases from 1979-2016. Low-wage workers affected by the wage floor saw a significant increase in earnings of ~ 7%.

That being said, increases in earnings only matter if there are workers to benefit from the higher wages. Theory predicts that firms respond to increases in wages by decreasing labor in competitive markets. In reality, there is uncertainty in the magnitude and area of disemployment following an increase in the minimum wage. Jardim e al find no significant decreases in manpower but significant losses to hours per worker. Low-skill workers seem to bear the majority of these costs as firms shift towards more experienced labor. Cengiz et al do not find similar results. They find no significant employment effects except in competitive markets with high levels of trade, where firms do not have the room to eat higher labor costs while maintaining the same level of production. Low-skill workers also seem to benefit similarly to higher-skilled workers in the aggregated data. In general, the number of new jobs above or at the minimum wage seems to offset the number of jobs lost below it.

One important caveat to the discussion of employment effects is their duration. If negative employment effects fall away over time, there is less of a challenge to implementing a good minimum wage policy. In his paper “Are There Long-Run Effects of the Minimum Wage?” Isaac Sorkin finds that negative employment effects tend to trend back toward zero in the long run. The study is focused primarily on the restaurant industry, meaning these estimates are for an industry that sustains the largest drops in employment; these results should then carry over to industries that see less-extreme reactions.

Overall, the benefits of minimum wage changes seem to outweigh the costs, except in highly competitive markets where more caution must be utilized. Following the evidence, I believe that indexing the minimum wage to the local cost of living would both benefit low-wage workers and be an improvement where a flat increase falls short by protecting them in the long run from failure to enact consistent policy, as in the 80s.

References

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