ISSUE

Should Minimum Wage and Living Wage Laws Be Eliminated?

YES: D. W. MacKenzie, from "Mythology of the Minimum Wage," Ludwig von Mises Institute (May 3, 2006)

NO: Jeannette Wicks-Lim, from "Measuring the Full Impact of Minimum and Living Wage Laws," *Dollars & Sense* (May/June 2006)

Learning Outcomes

After reading this issue, you will be able to:

- Describe "Okun's law" about the relationship between unemployment and GDP.
- Identify the apparent party lines on minimum wage laws.
- Discuss the stagnation, in nominal terms, of the minimum wage over the nine years preceding 2006.
- Cite the history of the pre–minimum-wage unemployment rate as far back as 1902.

ISSUE SUMMARY

YES: Economics instructor D. W. MacKenzie believes that eliminating minimum wage laws would "reduce unemployment and improve the efficiency of markets for low productivity labor." He also believes that the "economic case for a living wage is unfounded."

NO: Economist Jeannette Wicks-Lim stresses the ripple effects of minimum and living wage laws; these effects increase the "effectiveness" of minimum and living wage laws as "antipoverty strategies."

Congress passed the Fair Labor Standards Act (FLSA) of 1938 in the midst of the Great Depression. In one bold stroke, it established a minimum wage rate of $.25 an hour, placed controls on the use of child labor, designated 44 hours as the normal work week, and mandated that time-and-a-half be paid to anyone working longer than the normal work week. Sixty-eight years later the debates concerning child labor, length of the work week, and overtime pay have long subsided, but the debate over the minimum wage rages on.

The immediate and continued concern over the minimum wage component of the FLSA should surprise few people. Although $.25 an hour is a paltry sum compared to today's wage rates, in 1938 it was a princely reward for work. It must be remembered that jobs were hard to come by, and unemployment rates at times reached as high as 25 percent of the workforce. When work was found, any wage seemed acceptable to those who roamed the streets with no safety net to protect their families. Indeed, consider the fact that $.25 an hour was 40.3 percent of the average manufacturing wage rate for 1938.

Little wonder, then, that the business community in the 1930s was up in arms. Business leaders argued that if wages went up, prices would rise. This would choke off the little demand for goods and services that existed in the marketplace, and the demand for workers would be sure to fall. The end result would be a return to the depths of the depression, where there was little or no hope of employment for the very people who were supposed to benefit from the Fair Labor Standards Act.

Simple supply-and-demand analysis supports this view. As modern-day introductory textbooks in economics invariably show, unemployment occurs when a minimum wage greater than the equilibrium wage is mandated by law. The simplistic analysis, which assumes competitive conditions in both the product and factor markets, is predicated upon the assumptions that as wages are pushed above the equilibrium level, the quantity of labor demanded will fall and the quantity of labor supplied will increase. Wage rigidity prevents the market from clearing. The end result is an excess in the quantity of labor supplied relative to the quantity of labor demanded. The same would be true for the imposition of a living wage above the equilibrium wage.

The question that should be addressed in this debate is whether or not a simple supply-and-demand analysis is capable of adequately predicting what happens in real-world labor markets when a minimum wage or living wage is introduced or an existing minimum/living wage is raised. The significance of this is not based on idle curiosity. The minimum wage has been increased numerous times since its introduction in 1938. The current federal minimum wage of $7.25 was set in 2009. Did this minimum wage increase, and other increases before it, do irreparable harm to those who are least able to defend themselves in the labor market, the marginal workers? That is, if a minimum wage is imposed, what happens to all those marginal workers whose value to the firm is something less than the minimum wage? Are these workers fired? Do firms simply absorb this cost increase in the form of reduced corporate profits? What happens to productivity?

D. W. MacKenzie argues that eliminating the minimum wage would increase economic efficiency in the labor market for teenagers and ethnic minorities, lowering their unemployment rates. Imposition of living wages would make their unemployment rates rise higher than they are already. Jeannette Wicks-Lim focuses on the ripple effects of minimum wages and living wages, that is, how much would the wages of *other* workers increase as a result of an increase in the minimum wage? The larger the ripple effects, the stronger the case for higher wage minimums to improve the lives of the working poor.

YES

D. W. MacKenzie

Mythology of the Minimum Wage

Once again politicians and pundits are calling for increases in the legal minimum wage. Their reasons are familiar. Market wages are supposedly immoral. People need to earn a "living wage." If the minimum wage went up at least to $7, or better still to near $10 an hour, millions would be lifted out of poverty.[1]

The economic case against minimum wage laws is simple. Employers pay a wage no higher than the value of an additional hour's work. Raising minimum wages forces employers to dismiss low productivity workers. This policy has the largest [effect] on those with the least education, job experience, and maturity. Consequently, we should expect minimum wage laws to affect teenagers and those with less education. Eliminating minimum wage laws would reduce unemployment and improve the efficiency of markets for low productivity labor.

There are a few economists who have been leading the charge for higher minimum wages. Some of these economists have obvious ideological leanings. Economists connected with the Left-orientated Economic Policy Institute and the Clinton Administration have concocted a rational for minimum wage increases. According to these economists higher wages make employees more content with their jobs, and this leads to higher worker productivity. Thus workers will be worth paying a minimum wage once their employers are forced to pay these wages. Of course, if this were true—if employers could get higher productivity out of less educated and experienced workers by paying higher wages—they would be willing to do this without minimum wage legislation. But the economists who make this case claim to have empirical evidence that proves them right. Economists David Card and Alan Krueger have published studies of the fast food industry [indicating] that small increases in the minimum wage would cause only minor job losses, and might even increase employment slightly in some instances. These studies by Card and Krueger show only that a small increase in minimum wage rates might not cause much of an increase in unemployment. Such studies ignore the fact that the current level of minimum wages are already causing significant unemployment for some workers.

The economic case for minimum wage increases has gained some ground with public and even professional opinion. Even some free market leaning economists, like Steven Landsburg, have conceded that minimum wage increases do not affect employment significantly.[2] Landsburg notes that critics of minimum wage laws emphasize that they have a disproportionate effect on teens and blacks. But he dismisses these critics because "minimum wages have at most a tiny impact on employment . . . The minimum wage kills very few jobs, and the jobs it kills were lousy jobs anyway. It is almost impossible to maintain the old argument that minimum wages are bad for minimum-wage workers."

Real statistics indicate that the critics of minimum wage laws were right all along. While it is true that minimum wages do not drive the national unemployment rate up to astronomical levels, it does adversely affect teenagers and ethnic minorities. According to the Bureau of Labor Statistics the unemployment rate for everyone over the age of 16 was 5.6% in 2005. Yet unemployment was 17.3% for those aged 16–19 years. For those aged 16–17 unemployment was 19.7%. In the 18–19 age group unemployment was 15.8%. Minimum wage laws do affect ethnic minorities more so than others.[3] The unemployment rate for white teens in the 16–17 age group was 17.3% in 2005. The same figures for Hispanic and black teens were 25% and 40.9% respectively. Of course, these figures decrease for older minorities. Blacks aged 18–19 and 20–24 had 25.7% and 19.9% unemployment in 2005. For Hispanics unemployment was slightly lower—17.8% at age 18–19 and 9.6% at age 20–24.

Landsburg might maintain that most of these lost jobs are lousy jobs that teens will not miss. DeLong thinks that minimum wage laws can help to avert poverty—workers who keep their jobs at the minimum wage gain much, while unemployed workers lose little. Part of the problem with this argument is that it involves arbitrary value judgments. According to mainstream economic theory, we achieve economic efficiency when markets clear because this is how we realize all gains from trade. With teen unemployment in double digits—running as high as 40.9%—it is obvious that some labor markets are not clearing. If labor market imperfections led to such levels of unemployment, economists like DeLong, Card, and Krueger would call for government intervention to correct these "market failures." Yet they find double digit teen unemployment acceptable when it derives from government intervention. Why? Because they want to use such policies to redistribute income.[4]

Mainstream economic theory lacks any basis for judging the effects of income redistribution. According to textbook economics we attain the highest level of economic efficiency when markets clear, when we realize the maximum gains from mutually advantageous trade. Income transfers benefit some at the expense of others. Economists have no scientific methods for comparing gains and losses through income transfers.[5] Once economists depart from discussing efficiency conditions and begin to speak about income redistribution, they become advocates of a political agenda, rather than objective scientists. The jobs lost to minimum wage laws might not seem worthwhile to DeLong or Landsburg, but they obviously are worthwhile to the workers and employers whom these laws affect. Why should the value judgments of a few armchair economists matter more than the interests of would be employees and employers? These jobs may be "lousy jobs," but one could also argue that these jobs are quite important because they are a first step in gaining job experience and learning adult responsibility.

A second problem with the case against minimum wages is that they affect older workers too. As already noted, workers in the 20–24 age group appear to be affected by minimum wage laws. Unemployment rates in the 25–34 age group are higher than for the 35–44 age group. The unemployment rate for blacks and Hispanics aged 25–34 were 11.1% and 5.8% in 2005. Unemployment for whites and Asians in this age group were 4.4% and 3.5%. In the 35–44 age group the unemployment rates for these four ethnicities were 7.2%., 5.1%, 4.4%, and 2.7%. A comparison of black to Asian unemployment is revealing. In the United States, Asians tend to attain higher levels of education than blacks. Thus minimum wage laws are relatively unimportant to Asian Americans. Consequently, Asians are able to attain unemployment as low as the 2–3% range. For Asians aged 16+ the unemployment rate was only 3.3% in 2005. For Asians in the 20–24 age group unemployment was 5.1%. These figures are only a fraction of the unemployment rates experienced by blacks in 2005. There is no reason why white, Hispanic, and black Americans cannot also reach the 2–3% range of unemployment.

Supporters of minimum wage laws do not realize that prior to minimum wage laws the national unemployment rate did fall well below 5%. According to the US Census, national unemployment rates were 3.3% in 1927, 1.8% in 1926, 3.2% in 1925, 2.4% in 1923, 1.4% in 1919 and 1918, 2.8% in 1907, 1.7% in 1906, and 3.7% in 1902.[6] Even today, some states have unemployment rates as low as 3%. Virginia now has an unemployment rate of 3.1%. Wyoming has an unemployment rate of 2.9%. Hawaii has an unemployment rate of 2.6%. National unemployment rates seldom drop below 5% because some categories of workers are stuck with double digit unemployment. Given these figures, it is quite arguable that minimum wage laws keep the national unemployment rate 3 percentage points higher than would otherwise be the case.

Economist Arthur Okun estimated that for every 1% increase in unemployment GDP falls by 2.5–3%. If minimum wage laws are responsible for keeping the national unemployment rate 3 percentage points above where it would otherwise be, then the losses to minimum wage unemployment are substantial. Since Okun's law is an empirical proposition it is certainly not constant. Eliminating minimum wages might not increase GDP as much as this "law" indicates. However, the elimination of minimum wage laws would surely have a positive effect on GDP. In any case, economic theory and available data indicate that minimum wage laws do result in economic inefficiency. The implementation of a "living wage" would only increase these losses. Do proponents of living wages really want to see unemployment rates among ethnic minorities and teens climb even higher?

The economic case for a living wage is unfounded. Current minimum wage rates do create high levels of unemployment among low productivity workers. Higher "living wages" would only make these problems worse. The alleged moral case for a living wage ignores the fact that minimum wage increases adversely affect the very people whom advocates of living wages intend to help. If politicians wish to pursue sound policies, they should consider repealing minimum wage laws, especially where teens are concerned. Unfortunately, most politicians care more about political expediencies than sound economic policy. This being the case, minimum wages will increase unless public opinion changes significantly.

Notes

1. See Dreier and Candeale *A Moral Minimum Wage,* April 27, 2006 and Cauchon *States Say 5.15 too little,* April 27, 2006.
2. See *The Sin of Wages* by Steven Landsburg and *The Minimum Wage and the EITC* by J. Bradford DeLong.
3. This is likely due to the poor quality of many inner city public schools.
4. It is worth noting that Landsburg opposes redistribution via minimum wage laws.
5. This would require interpersonal comparisons of welfare. Robbins (1933) proved that such comparisons are unscientific.
6. US Bureau of the Census *Historical Statistics,* p. 135.

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EXPLORING THE ISSUE

Should Minimum Wage and Living Wage Laws Be Eliminated?

Critical Thinking and Reflection

1. Does "Okun's law" present a worthy factor in the debate over minimum and living wage laws? Explain.
2. If the "ripple effect" plays a lesser role in the case of living wage laws than in the case of minimum wage laws, why might that be?
3. Is it a reasonable prediction that employment rates for black and Hispanic teens could improve with the elimination of the minimum wage? Why or why not?
4. Why has the debate over minimum wage raged on since its inception in the Fair Labor Standards Act of 1938, while other issues addressed in that act (child labor, length of work week, overtime pay) have long ago lost their controversy?

Is There Common Ground?

Statistical analysis, which certainly can be a valuable discipline, can also be utilized by opposing points of view, to the advantage of each. Which numbers are examined and the interpretations derived from them definitely play key roles in each presentation of this debate. Not unlike many opposing analyses, the statistics cited here are clearly selected to support each side's original premise.

So, while their conclusions may be quite different, one from the other, MacKenzie and Wicks-Lim do have a shared purpose: they both believe in a strong workforce, equitable employment opportunities, and the lowest unemployment figures possible. Although they disagree on the effects that minimum wage has on these ideals, the common ground of the ideals themselves is significant.

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Additional Resources

Landsburg, Steven E., *The Armchair Economist: Economics and Everyday Life* (Free Press, 2012)

Pollin, Robert, et al., *A Measure of Fairness: The Economics of Living Wages and Minimum Wages in the United States* (ILR Press, 2008)

Stabile, Donald R., *The Living Wage: Lessons from the History of Economic Thought* (Edward Elgar, 2009)

Internet References . . .

David Card (Berkeley): "Minimum Wages and Employment: A Case Study of the Fast-Food Industry in New Jersey and Pennsylvania"

http://davidcard.berkeley.edu/papers/njmin-aer.pdf

The Economist: "Living-Wage Laws: Bad Welfare"

www.economist.com/blogs/democracyinamerica/2013/07/living-wage-laws

United States Department of Labor

www.dol.gov/whd/minwage/coverage.htm