2006

Minimum Wage, Minimum Sense

Henderson, David R.

Wall Street Journal

Minimum Wage, Minimum Sense

Henderson, David R . Wall Street Journal , Eastern edition; New York, N.Y. [New York, N.Y]25 Feb 2006: A.11.

ABSTRACT (ABSTRACT)

The law of demand says that at a higher price, less is demanded, and it applies to grapefruit, cars, tickets to Terminator movies and, yes, labor. Since a legislated increase in the price of labor does not magically increase workers' productivity, some workers -- the least- productive ones -- will lose their jobs. That's why economists looking for the effect of the minimum wage on employment don't look at data on 45-year-old men but, instead, on teenagers and young adults, especially black teenagers and young adults. Paul Samuelson, the first American winner of the Nobel prize in economics, put it succinctly back in the 1960s, when analyzing a proposal to raise the minimum wage to $2 an hour: "What good does it do a black youth to know that an employer must pay him $2 an hour if the fact that he must be paid that amount is what keeps him from getting a job?"

It is a question that proponents of the minimum wage typically ignore. Nevertheless, a comprehensive survey of studies of the minimum wage found that a 10% increase in the minimum wage reduces employment of young workers by 1% to 2%. If this estimate holds for California, therefore, Gov. [Arnold Schwarzenegger]'s proposed 15% increase would destroy 1.5% to 3% of young Californians' jobs -- about 35,000 to 70,000 jobs. The effects, percentage-wise, would be even bigger for teenagers. Some might argue that teenagers should be in high school or college anyway. Unfortunately, a higher minimum wage entices some of them already in school to drop out -- and take the jobs of some of those less-educated and lower-productivity teens who had already dropped out.

FULL TEXT

Attempts to raise the federal minimum wage have been stymied for several years; nevertheless, campaigns to raise state- and city- mandated minimums continue apace: This year there are efforts to raise the minimum wage in as many as 11 states. Meanwhile, the nation's most populous state is poised to fall without a fight. California Gov. Arnold Schwarzenegger, after humiliation at the polls in November, now advocates raising the state minimum wage from its current $6.75 an hour to $7.75 by July 2007. Since that's what the Democrat-dominated legislature wants, Californians will no doubt benefit from this increase. Or will they?

While there's some truth to the old joke about economists never agreeing on anything, most of us actually agree on a lot, including the fact that when the minimum wage law confronts the law of demand, the law of demand wins every time. And the losers will be the least- skilled workers, who will be out of a job. The wage that exists in the absence of a legally mandated minimum reflects the willingness of workers to work (supply) and the willingness of employers to hire them (demand); and the main determinant of what employers are willing to pay is the productivity of workers. That's why most working people are not directly affected by the minimum wage: Their productivity and, hence, their pay, are already well above it.

The law of demand says that at a higher price, less is demanded, and it applies to grapefruit, cars, tickets to Terminator movies and, yes, labor. Since a legislated increase in the price of labor does not magically increase workers' productivity, some workers -- the least- productive ones -- will lose their jobs. That's why economists looking for the effect of the minimum wage on employment don't look at data on 45-year-old men but, instead, on teenagers and young adults, especially black teenagers and young adults. Paul Samuelson, the first American winner of the Nobel prize in economics, put it succinctly back in the 1960s, when analyzing a proposal to raise the minimum wage to $2 an hour: "What good does it do a black youth to know that an employer must pay him $2 an hour if the fact that he must be paid that amount is what keeps him from getting a job?"

It is a question that proponents of the minimum wage typically ignore. Nevertheless, a comprehensive survey of studies of the minimum wage found that a 10% increase in the minimum wage reduces employment of young workers by 1% to 2%. If this estimate holds for California, therefore, Gov. Schwarzenegger's proposed 15% increase would destroy 1.5% to 3% of young Californians' jobs -- about 35,000 to 70,000 jobs. The effects, percentage-wise, would be even bigger for teenagers. Some might argue that teenagers should be in high school or college anyway. Unfortunately, a higher minimum wage entices some of them already in school to drop out -- and take the jobs of some of those less-educated and lower-productivity teens who had already dropped out.

Gov. Schwarzenegger's uncle-in-law, Ted Kennedy, argues that the minimum wage should be increased because it's difficult to raise a family with the only breadwinner making the current minimum. It's a popular claim, but it is flawed, for three reasons.

-- First, a study by economist David A. Macpherson of Florida State University and Craig Garthwaite of the Employment Policies Institute suggests that only 20% of the workers who would have been directly affected by an earlier $1 increase in California's minimum wage were supporting a family on a single minimum-wage income. The other 80% were teenagers or adult children living with their parents, adults living alone or dual earners in a married couple.

-- Second, as economists David Neumark of the Public Policy Institute of California and William Wascher of the Federal Reserve Board show, increases in minimum wages actually redistribute income among poor families by giving wage increases to some and putting others out of work. They estimate that the federal minimum-wage increase of 1996 and 1997 increased the proportion of poor families by one half to one percentage point.

-- Third, consider the long run. Mr. Neumark and Olena Nizalova have found that even people in their late 20s worked less and earned less the longer they were exposed to a high minimum wage, presumably because the minimum wage destroyed job opportunities early in their work life.

There is also equity -- how can we justify forcing employers, the very people who are taking risks to provide jobs in the first place, to pay a higher wage? If "society" decides that unskilled people should receive more income, why shouldn't taxpayers provide it?

Many Democrats in California who support a higher minimum wage probably don't understand its nasty effects on younger, less- productive workers. But there's a less benign reason: The Democratic Party and many of its members are closely affiliated with unions. Union members themselves almost always make more than the minimum wage but support it anyway, because it hobbles competition from low-wage workers.

Northeastern politicians, for example, have traditionally favored high federal minimum wages partly to stem the flow of jobs to the lower-wage South. Indeed, in 1957, Sen. John Kennedy argued for a higher minimum because it would make low-wage black workers in the South less competitive with the higher-wage white workers whom he represented.

To his credit, Gov. Schwarzenegger wants to avoid indexing the minimum wage either to the consumer price index or to a wage index, something that his Democrat opponents badly want, and which a coalition of labor unions and social-welfare groups wants to put on the ballot this November. If indexing were implemented, it would be much harder to ever get the inflation-adjusted minimum wage down, making it permanently harder for the least-skilled workers to find jobs.

But let's not give him too much credit. In 2004, when Gov. Schwarzenegger vetoed a minimum-wage bill very similar to the one he now proposes, he stated, "Now is not the time to create barriers to our economic recovery." So it's worth asking him, "Is now the right time to create barriers to our economic recovery, Mr. Governor?"

Mr. Henderson is a research fellow at the Hoover Institution and co- author of "Making Great Decisions in Business and Life" (Chicago Park Press, 2006).