

4. Why do you think we have laws that prohibit discrimination in pay based on gender or race but permit employers to discriminate in pay based on education or experience?
5. Suppose you own a company. If you hire ten men, each of them at \$70,000 per year, your firm will be able to sell \$1,000,000 in output this year, and you will be able to earn \$50,000 in profits, an amount that is normal for a firm of your size in your industry. (Your firm's other costs, such as for rent and advertising, will be \$250,000 this year.) Now assume that you could hire ten women for \$56,000 each, instead of hiring the men. What would your total profits be if you hired the women and they were just as productive as the more expensive men? Show all calculations.
6. Refer back to the last question. Based on the discussion in the chapter, what would you want to know about these women to satisfy yourself that they will be at least as productive as the men? List the key factors and explain briefly.

CHAPTER 14

The Effects of the Minimum Wage

Ask workers if they would like a raise, and the answer will likely be a resounding yes. But ask them if they would like to be fired or have their hours of work reduced, and they would probably tell you no. The effects of the minimum wage are centered on exactly these points.

Proponents of the **minimum wage**—the lowest hourly wage firms may legally pay their workers—argue that low-income workers are underpaid and therefore unable to support themselves or their families. The minimum wage, they say, raises earnings at the bottom of the wage distribution, with little disruption to workers or businesses. Opponents claim that most low-wage workers don't have families to support. The minimum wage, they say, merely enriches a few at the far greater expense of many others, who can't get jobs. Most important, opponents argue, many individuals at the bottom of the economic ladder lack the skills needed for employers to hire them at the federal minimum. Willing to work but unable to find jobs, these people never learn the basic job skills needed to move up the economic ladder to higher-paying jobs. The issues are clear—but what are the facts?

BACKGROUND

The federal minimum wage was instituted in 1938 as a provision of the Fair Labor Standards Act. It was originally set at 25 cents per hour, about 40 percent of the average manufacturing wage at the time. Over the next forty years, the legal minimum was raised periodically, roughly in accord with the movement of market wages throughout the economy. Typically, its level has averaged between 40 and 50 percent of average manufacturing wages. In response to the high inflation of the late 1970s, the

minimum wage was hiked seven times between 1974 and 1981, reaching \$3.35 per hour—about 42 percent of manufacturing wages. President Ronald Reagan vowed to keep a lid on the minimum wage, and by the time he left office, the minimum's unchanged level left it at 31 percent of average wages. Legislation passed in 1989 raised the minimum to \$3.80 in 1990 and \$4.25 in 1991. Five years later, Congress raised it in two steps to \$5.15 per hour. Over the period 2007–2009, the minimum was hiked in three steps to its current level of \$7.25 per hour.

About 1.5 million workers earn the minimum wage. Another 1.8 million are paid even less because the law doesn't cover them. Supporters of the minimum wage claim that it prevents exploitation of employees and helps people earn enough to support their families and themselves. Even so, at \$7.25 per hour, a full-time worker earns only about two-thirds of what the government considers enough to keep a family of four out of poverty. In fact, to get a family of four with one wage earner up to the poverty line, the minimum wage would have to be \$12.00 per hour.

Yet opponents of the minimum wage argue that such calculations are irrelevant. For example, 98 percent of married people earn *above* the minimum wage, and single people paid the minimum earn enough to put them 30 percent above the poverty cutoff. Overall, about one-quarter of minimum wage workers are teenagers, most of whom have no financial obligations, except perhaps clothing and automobile-related expenditures. Thus, opponents argue that the minimum wage chiefly benefits upper-middle-class teens who are least in need of assistance at the same time that it costs the jobs of thousands of disadvantaged minority youths.

DOES LOW-WAGE MEAN LOW-INCOME?

Much of the discussion of the minimum wage glosses over the very real distinction between “low wage” and “low income.” If we go back to 1939, just after the federal minimum wage was established, we find that 85% of low-wage workers were in poor families. Hence, the original minimum wage did a good job of targeting the poor. Fast-forward to the present, and only 18 percent of low-wage workers are now in poor families.

There are several reasons why there is only a weak link between low-wage and low-income today. First, due to the rising incidence of multiple-earner families, many low-wage workers are in higher-income families. Second, some workers in poor families earn more than the minimum hourly wage but, voluntarily or otherwise, don't work enough hours to get out of poverty. Finally, about half of poor families have no workers at all. The net effect of these factors is that only 18% of the

benefits of a higher minimum wage would go to the poor—and 34% would go to families earning more than triple the poverty line.

RECENT EVIDENCE

The debate over the minimum wage intensified a few years ago when research suggested that a change in the New Jersey minimum wage had no adverse short-run impact on employment. Further research by other scholars focusing on Canada reveals more clearly what actually happens when the minimum wage is hiked. In Canada, there are important differences in minimum wages both over time and across different provinces. These differences enabled researchers to distinguish between the short- and long-run effects of changes in minimum wages. The short-run effects are indeed negligible, as implied by the New Jersey study. But the Canadian research shows that in the long run, the adverse effects of a higher minimum wage are quite substantial. In the short run, it is true that firms do not cut their workforce by much in response to a higher minimum. But over time, the higher costs due to a higher minimum wage force smaller firms out of business, and it is here that the drop in employment shows up clearly.

The Canadian results are consistent with the overwhelming bulk of U.S. evidence on this issue, which points to a negative impact of the minimum wage on employment. After all, the number of workers demanded, like the quantity demanded for all goods, responds to price: The higher the price, the lower the number desired. There remains, however, debate over how many jobs are lost due to the minimum wage. For example, when the minimum wage was raised from \$3.35 to \$4.25, credible estimates of the number of potential job loss ranged to 400,000.

When the minimum was hiked to \$5.15, researchers suggested that at least 200,000 jobs were at stake. More recently, economists have estimated that the latest increase in the federal minimum wage to \$7.25 from \$6.55 caused 300,000 people to lose their jobs. With a workforce of over 155 million persons, numbers like these may not sound very large. But most of the people who don't have jobs as a result of the minimum wage are teenagers. They comprise less than 5 percent of the workforce but bear almost all the burden of foregone employment alternatives.

THE BIG LOSERS

Significantly, the youths most likely to lose work due to the minimum wage are disadvantaged teenagers, chiefly minorities. On average, these teens enter the workforce with the fewest job skills and the greatest need for on-the-job training. Until and unless these disadvantaged teenagers

can acquire these skills, they are the most likely to be unemployed as a result of the minimum wage—and thus least likely to have the opportunity to move up the economic ladder. With a teen unemployment rate triple the overall rate and unemployment among black youngsters around 30 percent, critics argue that the minimum wage is a major impediment to long-term labor market success for minority youth.

Indeed, the minimum wage has an aspect that its supporters are not inclined to discuss: It can make employers more likely to discriminate on the basis of gender or race. When wages are set by market forces, employers who would discriminate face a reduced, and thus more expensive, pool of workers. But when the government mandates an above-market wage, the result is a surplus of low-skilled workers. It thus becomes easier and cheaper to discriminate. As former U.S. Treasury secretary Lawrence Summers noted, the minimum wage “removes the economic penalty to the employer. He can choose the one who’s white with blond hair.”

Critics of the minimum wage also note that it makes firms less willing to train workers lacking basic skills. Instead, companies may choose to hire only experienced workers whose abilities justify the higher wage. Firms are also likely to become less generous with fringe benefits in an effort to hold down labor costs. The prospect of more discrimination, less job training for low-skilled workers, and fewer fringe benefits for entry-level workers leaves many observers uncomfortable. As the economist Jacob Mincer noted, the minimum wage means “a loss of opportunity” for the hard-core unemployed.

LIVING WAGES?

Despite these adverse effects of the minimum wage, many state and local governments believe that people with jobs should be paid a wage on which they can “afford to live.” In fact, some states and localities mandate that minimum wages (sometimes called “living wages”) be even higher, at levels above \$10 an hour in Santa Fe, New Mexico, and San Francisco, California (with the minimum slated to reach \$15 in San Francisco by 2018). Sometimes, as in Baltimore, Maryland, the local minimum wage applies only to workers at firms that do business with the relevant government entity. But in the case of the Santa Fe and San Francisco minimum wages, as well as all state-determined minimum wages, the law applies to all but a few firms that are exempt due to their very small size or their industry (such as agriculture).

When politicians decide to raise the minimum wage, it is only after heated battles often lasting months. Given the stakes involved—an improved standard of living for some and a loss of job opportunities for

others—it is not surprising that discussions of the minimum wage soon turn to controversy. As one former high-level U.S. Department of Labor official said, “When it comes to the minimum wage, there are no easy positions to take. Either you are in favor of more jobs, less discrimination, and more on-the-job training, or you support better wages for workers. Whatever stance you choose, you are bound to get clobbered by the opposition.” When Congress and the president face this issue, one or both usually feel the same way.

DISCUSSION QUESTIONS

1. Are teenagers better off when a higher minimum wage enables some to earn higher wages but causes others to lose their jobs?
2. Are there methods other than a higher minimum wage that could raise the incomes of low-wage workers without reducing employment among minority youngsters?
3. Why do you think organized labor groups, such as unions, are supporters of a higher minimum wage, even though all of their members earn much more than the minimum wage?
4. Is it possible that a higher minimum wage could ever *increase* employment?
5. Even without a minimum wage, the unemployment rate would almost surely be higher among teenagers than among adults. Suggest at least two reasons why this is so.
6. Why is it teenagers (rather than members of any other age group) who are most likely to lose their jobs (or get turned down for employment) when the minimum wage is raised?