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## *The Effects of the Minimum Wage*

Ask workers if they would like a raise and the answer is likely to 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 legally may 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 are low-skilled youths without families to support. The minimum wage, they say, merely enriches a few teenagers 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?

The federal minimum wage was instituted in 1938 as a provision of the Fair Labor Standards Act (FLSA). It was originally set at \$0.25 per hour, about 40 percent of the average manufacturing wage at the time. Over the next 40 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 percent 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. Ronald Reagan vowed to keep a lid on the minimum wage, and by the time he stepped down as president, 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, at the urging of President Clinton, Congress raised it in two steps to \$5.15 per hour. By the time you read this, it is likely that the minimum wage will have been increased again.

Nearly 600,000 workers earn the minimum wage; another 1.6 million or so take home 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 \$5.15 per hour, a full-time worker earns less than 60 percent 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 over \$9.00 per hour.

Yet those who oppose the minimum wage argue that such calculations are irrelevant. For example, two-thirds of the workers earning the minimum wage are single, and they earn enough to put them above the poverty cutoff. Moreover, about half of these single workers are teenagers, most of whom have no financial obligations, except possibly for their clothing and car insurance 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.

The debate over the minimum wage intensified a few years ago when research by David Card and Alan Krueger 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 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-run and long-run effects of changes in minimum wages. The short-run effects are indeed negligible, as implied by Card and Krueger. 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, if at all, 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 the 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 losses ranged from 50,000 all the way up to 400,000. When the minimum was hiked to \$5.15, researchers suggested that at least 200,000 jobs were at stake. With a workforce of 150 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 only about 5 percent of the workforce but bear almost all of the burden of forgone employment alternatives.

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 better than triple the overall rate, and unemployment among black youngsters hovering 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 sex 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, a surplus of low-skilled workers results, and it 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 argue 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 economist Jacob Mincer of Columbia University notes, the minimum wage means “a loss of opportunity” for the hard-core unemployed.

The last time Congress and the president agreed to raise the minimum wage, it was only after a heated battle lasting months. Given the stakes involved—an improved standard of living for some, 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 the Congress and the president face this issue, one or both parties usually feel the same way.

### DISCUSSION QUESTIONS

1. Are teenagers better off when a higher minimum wage enables some to get 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 their members all earn much more than the minimum wage?
4. Is it possible that a higher minimum wage could ever *raise* employment?