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# Is It Time to Abolish the Minimum Wage?

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## Introduction

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- ◆ It is well known that the minimum wage creates unemployment among the least skilled workers by raising rates above the free market levels. Some of the other effects of minimum wages are a reduction in nonwage benefits, labor substitution effects, capital substitution, racial discrimination, human capital development, and market distortion.

## Economic Effects

### ◆ Unemployment Effects

- 1933 National Recovery Administration established the 1<sup>st</sup> federal minimum wage laws.
- Evidence showed that there was significant unemployment effect from the minimum wage, about 500,000 African-Americans were out of work and there was major discrimination between old and young workers.
- 1935 Supreme Court ruled NRA unconstitutional

## Economic Effects

### ◆ Unemployment Effects

- 1937 Supreme court case *West Coast Hotel v. Parrish* paved the way for a new minimum wage law.
- 1938 President Roosevelt passed the Fair Labor Standards Act (FLSA).
- The end effect was extremely counterproductive

## Economic Effects

### ◆ Unemployment Effects

- Thousands lost their jobs as a result of the minimum wage laws, most of which were in low-skilled, low-wage work areas.
- Empirical evidence, of over 50 years, shows that the minimum wage does in fact increase unemployment.
- The question is no longer *if* the minimum wage will increase unemployment, but by *how much*.

## Economic Effects

### ◆ Employment in Uncovered Sectors

- Labor market is split into 2 sectors; those covered by minimum wage, and those that are not.
- Employees in the covered sector who do not lose their jobs enjoy a higher wage, but at the expense of the unemployed workers.
- Those employees in the uncovered sector, earning the lowest wages in this sector, experienced a wage decrease due to the minimum wage increases.
- Some of the uncovered sector helped absorb some of the unemployment in the past, but this “safety valve” is vanishing.

## Economic Effects

### ◆ Nonwage Benefits

- Some of the amenities that workers enjoy at the cost of a lower wage are taken when a minimum wage that is greater than the previous wage is introduced.
- **I.E.** A worker gets \$3.00/hr and is happy because he also enjoys many benefits. Minimum wage laws go up to \$3.25/hr and the worker loses his benefits and is forced to pay for what was lost then he is worse off with the minimum wage.

## Economic Effects

### ◆ Labor Substitution

- Low wage workers are substitutes for high wage workers
- Low wage vs. High skill workers
- Minimum wage works against low-skill workers

## Economic Effects

### ◆ Capital Substitution

- Minimum wage makes low-skill labor less attractive compared to automated machinery
- Low-skill worker vs. Automatic Dishwasher
- As low-skill jobs are lost, high-skill jobs are created

## Economic Effects

### ◆ Racial Discrimination

- Minimum wage makes it affordable for employers to discriminate
- South Africa racist unions and equal pay legislation
- Firms will maximize profit by hiring workers who demand less wage but have the same skills

## Economic Effects

### ◆ Human Capital Development

- Minimum wage laws restrict the employment of low-skill workers when the wage rate exceeds the workers' marginal productivity.
- Human capital accumulates over time
- "It is unfortunate and ironic that we encourage and subsidize expenditure on formal education while blocking the opportunity for individuals to 'buy' on-the-job training." (Feldstein)

## Economic Effects

### ◆ Distortion of the Market Process

- Minimum wages lead to the wrong factor input mix between labor and all other inputs.
- The existence of price differentials, as knowledge to be transmitted through relative prices, is hidden.
- Puerto Rico: Aggregated effects of these distortions could lead to fewer production of goods and services. [...] Minimum wage law could be expected to reduce the rate of improvement in the standard of people's life and to intensify poverty.

## Outside Evidence

- ◆ According to the 1981 Report of the Minimum Wage Study Commission, the 46 percent rise in the minimum wage between 1977 and 1981 destroyed 644,000 jobs among teenagers alone. “The evidence is now in, and the findings of dozens of major economic studies show that the damage done by the minimum wage has been far more severe than even the critics . . . predicted.” (S. Warne Robinson)
- ◆ A 1983 survey, “Time-Series Evidence of the Effect of the Minimum Wage on Youth Employment,” found that studies conducted between 1973 and 1983 generally agreed that a 10 percent increase in the minimum wage would result in a 1 to 3 percent reduction in teenage employment. (Brown, Gilroy, and Cohen)

## Outside Evidence

- ◆ Teenagers suffer most from the adjustments required by an increase in the minimum-wage rate. These workers are generally the least experienced, least skilled, and least productive. According to the Bureau of Labor Statistics, the present unemployment rate for all teenagers actively seeking jobs is 16.5 percent, and the unemployment rate for black teenagers is 29.7 percent, almost twice as high as the overall average. (Source: Bureau of Labor Statistics)
- ◆ The damage done to teenagers is twofold. First, they lose income immediately. Second, because minimum-wage legislation has rendered them unemployable, teenagers cannot gain the experience and skills that would make them employable at higher wages later. If there were no floor price on labor, teenagers could offer to work for a lower price until they had gained the training, experience, and skills they needed to command a higher wage.

## Outside Evidence

- ◆ Simply stated, if the government coercively raises the price of some good (such as labor) above its market value, the demand for that good will fall, and some of the supply will become "disemployed."
- ◆ Any artificial increase in labor costs aggravates inflation by pushing up the costs of individual business and can produce so-called cost-push inflation.
  - Many firms may be unable to pass on their increased costs to consumers. It is consumers who ultimately determine the price of any good on the market, and they may decide that a business' product is not worth a higher price.
  - If a business cannot simply pass along its new labor costs, it must somehow absorb them—by eliminating workers rendered unproductive by the new minimum wage, by replacing labor with more-productive machines, or by cutting back production.

## Conclusion

- ◆ George Stigler may have startled some economists in 1946 when he claimed that minimum wage laws create unemployment and make people who had been receiving less than the minimum poorer.
- ◆ However, some 50 years of experience with the law has proven Stigler correct, leaving very few defenders in the economics profession.
- ◆ What has been touted as a matter of basic economic justice turns out to be a self-serving issue for many of its supporters. If the minimum wage is increased, labor unions and their influential friends in Congress will make big gains. Unfortunately, everyone else will lose.



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## Conclusion

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- ◆ In the long run, however, such policies will hurt everyone. As unemployment increases, business becomes more and more unproductive, and the overall quality of life declines, all Americans will suffer.
- ◆ Regardless of the intentions of its supporters, the proposed minimum-wage legislation cannot achieve their stated goal of raising the real income of the poor to a more livable level. Indeed, it is an extremely short-sighted policy that can only breed destruction, by eliminating the jobs of those who need work most: the poor, the young, and those suffering from discrimination.