Raising the Minimum Wage Will Do No Harm? It Just Ain't So!

BY RICHARD B. MCKENZIE

President Bush and the Democratically controlled Congress had all but done it. As this went to press, they were on the verge of hiking the federal minimum wage, which has not budged since 1997. The minimum wage has likely risen by 70 cents, or to $5.85, an hour by the time these words are read. The minimum will jump to $7.25, or by a total of $2.10, an hour over the next two years.

Supporters of the proposed minimum-wage hike of all political stripes have, once again, fallen prey to a common delusion that government can, with a wave of its magic legislative wand, suppress competitive market forces in any way deemed desirable.

Nevertheless, any actual increase in the minimum wage will likely have a minimum effect on employment and overall earnings of covered workers. This is partly because the federal legislative wand has never proved very potent.

A couple of hundred econometric studies on the employment effects of minimum-wage increases over the last four decades show that modest hikes (say, 10 percent) tend to have little to no employment impact, *even among the most vulnerable worker group*—teenagers (with teenage employment falling no more than 3 percent and very likely less than 1 percent of those employed with a 10 percent wage hike).

As usual, in the short recent congressional debate both opponents and proponents of minimum-wage hikes pushed totally wrongheaded arguments, because both groups fail to realize that while mandated wage laws contain competitive pressures exerted on *money wages*, they do not materially suppress the overall force of labor-market competition that low-wage workers have to confront. With a higher minimum wage, competitive pressures will simply be felt in nonmoney-wage dimensions of employment contracts.

Proponents have argued (as did Steven Pearlstein in the *Washington Post*, January 10) that the proposed wage hike will have "minimal" to no effect on employment, partly because the higher wage will inspire a productivity jump among covered workers and/or the higher wage costs will be passed along to consumers in higher prices. If competitive forces have these effects, should we not also expect those same forces to pressure firms to contain their labor costs in all ways possible, including curbs in nonmoney forms of compensation provided workers, which can dampen firms' need for productivity improvements and product price increases?

Opponents of minimum-wage hikes (for example, Gary Becker and Richard Posner writing for the *Wall Street Journal*, January 26) will magnify as best they can the employment effects of any mandated wage hike, not realizing that the available findings of little to no employment effects from modest minimum-wage increases actually support their more fundamental position, that government should not try to tamper with Mother Nature—or competitive market forces.

Menial workers are paid little not so much because of employer greed as because of their low productivity *and* competitive pressures in both their own labor markets and their employers' product markets. Those competitive pressures do not subside when the minimum wage is increased. If the wage hike gives rise, initially, to more workers looking for jobs than there are jobs available

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(as both sides agree will happen), employers can respond simply by taking away fringe benefits *and* increasing work demands, thus largely reducing, if almost negating, the cost effects of the mandated money-wage increase. (This explains the minimal measured effects of any minimum-wage hike.) A number of research studies support such an outcome:

- Writing in the *American Economic Review*, Masanori Hashimot found that under the 1967 minimum-wage hike, workers gained 32 cents in money income but lost 41 cents per hour in training—a net loss of 9 cents an hour in full-income compensation. Several other researchers in independently completed studies found more evidence that a hike in the minimum wage undercuts on-the-job training and undermines covered workers' long-term income growth.
- Walter Wessels found that the minimum wage caused retail establishments in New York to increase work demands by cutting back on the number of workers and giving workers fewer hours to do the same work.
- The research of Belton Fleisher, L. F. Dunn, and William Alpert shows that minimum-wage increases lead to large reductions in fringe benefits and to worsening working conditions.
- Mindy Marks found that workers covered by the federal minimum-wage law were also more likely to work part time, given that part-time workers can be excluded from employer-provided health insurance plans.
- If the minimum wage does *not* cause employers to make substantial reductions in nonmoney benefits and increases in work demands, then an increased minimum should cause (1) an increase in the labor-force-participation rates of covered workers (because workers would be moving up their supply of labor curves), (2) a reduction in the rate at which covered workers quit their jobs (because their jobs would then be more attractive), and (3) a significant increase in prices of production processes heavily dependent on covered minimum-wage workers. Wessels found that minimum-wage increases had exactly the opposite effect: (1) participation rates went down, (2) quit rates went up, and (3) prices did not rise appreciably—which are findings consistent only with the view that minimum-wage increases make workers worse off.

Quantifying the Harm

With the money-wage hike and the reduced benefits, workers can be left worse off since the fringes and slack work demands taken away were provided in the first place because workers valued them more highly than the wages forgone for those benefits. Given the findings of his own as well as other researchers' studies, Wessels deduces that every 10 percent increase in the hourly minimum wage will make workers 2 percent worse off. This means that the presumably enacted $2.10, or 39 percent, minimum-wage increase can be expected to leave affected workers 8 percent worse off in terms of their overall "payment bundle" (including the money and nonmoney benefits of employment).

Employers facing strong competition will be forced to cut out workplace advantages to neutralize as much as they can (but not totally) the imposed money-wage cost increase. That will be necessary just to avoid losing market position to those employers who respond to competitive pressures by cutting out the costly extras. The workers whose jobs are most at jeopardy from any minimum-wage hike will be that small group of (truly desperate) workers whose only form of compensation is their money wages and who are working as hard as humanly possible.

The sad outcome from any minimum-wage hike is that both employers' and employees' welfare will be undercut. The better news is that the forces of market competition will ensure that the damage done by politicians will be smaller than critics of minimum-wage hikes have heretofore recognized.

Congress and the President, of course, are doing what is politically expedient. In the process they have once again failed to heed a lesson that many market-oriented economists have always taught indirectly, if not directly, in their writings: You can't fool Mother Nature, and there is little constructive point in trying to fool competitive markets, even with the best of intentions.