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## HOW THE MINIMUM WAGE DESTROYS JOBS

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### INTRODUCTION

Congress last boosted the federal minimum wage in 1977, gradually raising it to \$3.35 per hour where it has been since 1981. Thanks to inflation, the minimum wage, in real terms, has declined by 27 percent in the past six years. This is prompting liberals to urge that the minimum wage be raised. Congressman Mario Biaggi, the New York Democrat, has introduced legislation to raise the minimum wage to \$5.05 over the next five years and automatically index it to 50 percent of average hourly wages thereafter. The proposal has the strong backing of organized labor and has been placed at the top of the legislative agenda for the Senate Committee on Labor and Human Resources by its new chairman, Edward Kennedy, the Massachusetts Democrat. Secretary of Labor William Brock has not yet indicated whether the Administration will oppose the legislation.<sup>1</sup>

There is no evidence that boosting the minimum wage would benefit the incomes of low-paid workers. There is substantial evidence that it would destroy jobs and thus reduce employment for many workers, especially minority youth. On this, professional economists are virtually unanimous. If Congress were to ignore this evidence and raise the minimum wage to the extent proposed by Biaggi, between 400,000 and 1,200,000 Americans could be made jobless. The impact

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1. See Kenneth B. Noble, "Now, Maximum Interest in the Minimum Wage," The New York Times, January 7, 1987; "Administration Is Undecided On Raising Minimum Wage," The Washington Post, January 14, 1987; "Raising the \$3.35 Minimum," Time, January 26, 1987, p. 19.

would be worse for black youths, who generally come into the job market with less education and poorer job skills than whites and therefore cannot justify the payment of \$3.35 per hour.

For this reason, inflation ironically has helped minority youth, at least in one respect. By eroding the real value of the minimum wage, it has made it possible for employers to offer jobs to many minority youths whom they otherwise could not have afforded to hire. Consequently, short of abolishing the minimum wage--which would be the best way to create jobs for disadvantaged teenagers--Congress at least should leave the minimum wage where it is.

#### SUPPORT FOR THE MINIMUM WAGE

Theoretical economics always has held that any measure that raises wages above their "market-clearing" (that is, free market) level will create unemployment. Were this not the case, advocates of the minimum wage could safely argue for a minimum of, say, \$100 per hour. Obviously, any politician attempting to make the argument for a \$100 minimum wage would not be taken seriously, since the adverse effects on employment would be too obvious. The same effects apply to any increase in the minimum wage. The only difference is that, when the level of the minimum wage is smaller, the negative effects are smaller and more easily missed.

A key reason why minimum wage laws continue to be supported is that many Americans believe they actually raise the wages of low-paid workers and that the rise in income for such workers offsets the loss of income by those thrown out of work by the minimum wage.<sup>2</sup>

A more important political reason for the minimum wage is that labor unions seek high minimum wage levels to reduce competition from nonunion workers.<sup>3</sup> If the legal minimum wage, for example, is only slightly lower than the union wage, then employers have little incentive to try to dislodge a union. The result: high minimum wages help unions maintain above-market wage rates.

A more subtle reason why minimum wage laws are supported has to do with the efforts by lawmakers representing areas with high wages to prevent businesses from migrating to areas with low wages. Representatives from high-wage northern states, for instance,

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2. Sar A. Levitan, Programs in Aid of the Poor, 5th ed. (Baltimore: The Johns Hopkins University Press, 1985), p. 125.

3. Milton Friedman and Rose Friedman, Free to Choose (New York: Harcourt Brace Jovanovich, 1980), p. 237.

traditionally have supported the minimum wage to block business expansion in the South. Economist H. C. Simons commented on this point in 1944, writing:

Southern workers may be intrigued by the wage expectations held out by organizers from northern states and by the Fair Labor Standards Act [that is, the federal minimum wage law]. They may in a few cases get such wages; but, if they get much employment at such wages, it will be only in spite of the intentions of the northern unions and the Massachusetts senators....It is simply contrary to the interests of northern workers to permit competitive expansion of southern industry in their respective fields; and prevent it they will if the power is theirs.<sup>4</sup>

#### EFFECT ON EMPLOYMENT

Though liberals once argued that the minimum wage had no effect on employment, today they generally admit that any rise in the minimum wage creates some unemployment. They insist, however, that such unemployment increase would be minimal. The evidence they cite most often is the congressionally mandated Minimum Wage Study Commission, which released its report in 1981 and estimated that a 10 percent increase in the minimum wage would reduce teenage employment by about one percent.<sup>5</sup> This one percent translates into a loss of 80,000 teenage jobs. The Biaggi bill's 50 percent boost in the minimum wage thus suggests a loss of some 400,000 jobs.

The impact almost surely will be higher. Many economists have found far higher unemployment effects from increases in the minimum wage than did the Minimum Wage Study Commission, which was dominated by liberals. Several studies have found that a 10 percent minimum

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4. Henry C. Simons, "Some Reflections on Syndicalism," Journal of Political Economy, March 1944, p. 10. For further elaboration on Northern support for the minimum wage against Southern interests, see Marshall R. Colberg, "Minimum Wages and the Distribution of Economic Activity," in Simon Rottenberg, ed., The Economics of Legal Minimum Wages (Washington, D.C.: American Enterprise Institute, 1981), pp. 247-263; and Marshall R. Colberg, "Minimum Wage Effects on Florida's Economic Development," Journal of Law and Economics, October 1960, pp. 106-117. Interestingly, a New York Times editorial referred to the 1977 increase in the minimum wage as a measure that would force the South to "pay fairer dues." See "Paying Fairer Dues in the South," The New York Times, August 20, 1977.

5. Report of the Minimum Wage Study Commission (Washington, D.C.: U.S. Government Printing Office, 1981), Vol. I, p. 38.

wage hike cuts teenage employment 2 to 3 percent, with far higher estimates for black male teenagers.<sup>6</sup> In light of these higher estimates, the Biaggi bill would increase the potential job loss to 1.2 million.

Ironically, the minimum wage seldom raises the unemployment rate. This seeming paradox stems from the fact that the unemployment rate does not measure the number of working age Americans without jobs but only those actually seeking work who cannot get it. This rate tends not to be affected substantially by raising the minimum wage because the raise prompts potential job seekers to withdraw from the labor force. Rises in the minimum wage apparently cause many low-skilled workers to become so discouraged at their prospects for obtaining employment at the higher minimum that they no longer look for work. Since they are no longer part of the labor force, they are no longer counted in the unemployment figures. Thus the minimum wage could create heavy unemployment without any significant rise in the unemployment rate. Indeed, the Minimum Wage Study Commission admitted that its low estimate for the unemployment effects of minimum wage increases was due to this factor.<sup>7</sup>

The minimum wage can affect employment in many other ways. Among them:

1) The minimum wage encourages employers to automate and substitute computers and other labor-saving equipment for workers.<sup>8</sup>

As the cost of employing workers in low-wage, manual labor jobs increases with rises in the minimum wage, the cost of mechanizing or automating such jobs becomes competitive. Thus there are more automated teller machines, more self-service gas pumps, and the like than when the minimum wage was lower.

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6. For a survey of recent studies, see Charles Brown, Curtis Gilroy, and Andrew Kohen, "The Effect of the Minimum Wage on Employment and Unemployment," Journal of Economic Literature, June 1982, pp. 487-528.

7. Report of the Minimum Wage Study Commission, op. cit.

8. This does not mean that jobs are destroyed in the aggregate, because automation creates jobs as others are destroyed. See Bruce Bartlett, "Is Industrial Innovation Destroying Jobs?" Cato Journal, Fall 1984, pp. 625-643.

2) The minimum wage drives workers out of jobs covered by the minimum wage into jobs not covered by minimum wage laws.<sup>9</sup>

If the minimum wage is raised, this may lead to an expansion of the so-called underground economy, which already employs millions of workers.<sup>10</sup>

3) The minimum wage increases aggregate unemployment during business cycles.

Employers do not have the option of asking workers employed at just above the minimum wage to reduce their wages temporarily during a recession if that would cause their wages to fall below the legal minimum. Thus such workers tend to be laid off. This is especially true if such workers are perceived to be secondary workers (that is, not heads of households).<sup>11</sup>

4) Employers tend to reduce fringe benefits in favor of cash wages as minimum wage rates rise.

This allows employers to avoid increasing labor costs while still complying with the law. An important implication of this is that the decline in fringe benefits has an impact on all workers, not just those affected by the minimum wage.<sup>12</sup>

5) Minimum wage laws make employers more choosy about whom they employ, encouraging them to fire less productive workers more quickly and take more time to fill particular jobs.

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9. For evidence on shifts in employment due to incomplete coverage, see Finis Welch, "Minimum Wage Legislation in the United States," Economic Inquiry, September 1974, pp. 285-318; and Yale Brozen, "Minimum Wage Rates and Household Workers," Journal of Law and Economics, October 1962, pp. 103-109.

10. See Peter M. Gutmann, "Are the Unemployed, Unemployed?" Financial Analysts Journal, September/October 1978, pp. 26-29.

11. Marvin Kusters and Finis Welch, "The Effects of Minimum Wages on the Distribution of Changes in Aggregate Employment," American Economic Review, June 1972, pp. 323-332; Finis Welch, Minimum Wages: Issues and Evidence (Washington, D.C.: American Enterprise Institute, 1978), pp. 38-41.

12. Walter J. Wessels, Minimum Wages, Fringe Benefits, and Working Conditions (Washington, D.C.: American Enterprise Institute, 1980).

In this way, minimum wage laws can increase the overall rate of unemployment without actually reducing the number of jobs available.<sup>13</sup>

6) Minimum wage laws tend to increase unemployment most in poor areas of the country.

The reason for this is simply that more workers are employed at the minimum wage in these areas, and the effect of the laws on a worker's employability is more significant.<sup>14</sup>

7) The minimum wage causes employers to be less inclined to accommodate special interests of their workers, such as providing part-time and temporary employment for workers unable to work regular full-time jobs.<sup>15</sup>

This is particularly important for women who often prefer part-time or temporary employment because it allows them to care for their children. In 1981, 69 percent of all women in the labor force worked part-time (which explains, in part,<sup>16</sup> much of the difference between male and female earnings levels).

8) The minimum wage may exacerbate inflation.

The minimum wage can have this effect because it increases production costs and encourages workers employed just above the

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13. Robert E. Hall, "The Minimum Wage and Job Turnover in Markets for Young Workers," in Richard B. Freeman and David Wise, eds., The Youth Labor Market Problem: Its Nature, Causes, and Consequences (Chicago: University of Chicago Press, 1982), pp. 475-492.

14. Ronald J. Krumm, The Impact of the Minimum Wage on Regional Labor Markets (Washington, D.C.: American Enterprise Institute, 1981).

15. Finis Welch, "The Rising Impact of Minimum Wages," Regulation, November/December 1978, p. 31.

16. Earl F. Mellor and George D. Stamas, "Usual Weekly Earnings: Another Look at Intergroup Differences and Basic Trends," Monthly Labor Review, April 1982, pp. 20-21.

minimum to press for higher wages. This cost increase then is passed on to consumers in the form of higher prices.<sup>17</sup>

9) The minimum wage drives down wages in sectors not covered by the legislation.

This effect occurs as workers forced out of their jobs by the minimum wage begin to compete for jobs not covered by the minimum wage.<sup>18</sup>

## EFFECTS ON MINORITIES

The negative effects of the minimum wage are greatest for minorities, especially black male teenagers. The reason: it makes employers more choosy about whom they hire and encourages them to hire only proved, dependable employees. The higher the minimum wage, the more dependable, skilled, and productive the candidate for a job must be if he or she is to produce more for the employer than the higher wages. This is why the impact is mainly on lower-skilled teenagers and not on adults, why the impact is greater on males than on females, and why the impact is greater on blacks than on whites.

Economist Walter Williams of George Mason University concludes that the minimum wage laws encourage discrimination. He writes:

The racial effect of the minimum wage laws exists in the absence of racial preferences on behalf of employers. The minimum wage law gives firms effective economic incentive to seek to hire only the most productive employees, which means that firms are less willing to hire and/or train the least productive employee, which includes teenagers, particularly minority teenagers. But assuming away any productivity differences between black and white

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17. Professor Raburn M. Williams of the University of Hawaii, for example, estimated that the January 1, 1979, increase in the federal minimum wage from \$2.65 to \$2.90 added "about one-third of a percentage point to the 1979 inflation rate." Raburn M. Williams, Inflation: Money, Jobs, and Politicians (Arlington Heights, Illinois: AHM Publishing Corp., 1980), p. 90. Of course, many other economists believe that excess money creation is the only cause of inflation and that "cost-push" factors, such as an increase in the minimum wage, have no effect. See J. Huston McCulloch, "Macroeconomic Implications of the Minimum Wage," in Rottenberg, op. cit., pp. 317-326.

18. John M. Abowd and Mark R. Killingsworth, "The Minimum Wage Law's Winners and Losers," The Wall Street Journal, September 10, 1981. See also Jacob Mincer, "Unemployment Effects of Minimum Wages," Journal of Political Economy, August 1976, part 2, pp. S87-S104.

workers, minimum wage laws give firms incentive to racially discriminate in hiring. The reason is that the minimum wage law lowers the private cost of discriminating against the racially less preferred person.<sup>19</sup>

In other words, the minimum wage lowers the cost of racial or any other form of discrimination, because it prevents those who may be objects of discrimination from being able to offer their labor at lower wages. Even the most bigoted employer would have to think twice about discriminating against a qualified black worker if that worker were willing to work for less than a comparable white worker. If the employer has to pay the same to both, then it costs him nothing to discriminate. This is not to say that paying a black worker less than a white worker is morally defensible--it is simply that it is preferable to a situation where the law allows an employer to discriminate without cost.

It is for this reason that the minimum wage has been essential to the development of apartheid in South Africa. Minimum wage laws were enacted explicitly to prevent white employers from hiring blacks who were willing to work for less than whites. The South African minimum wage laws have reduced black and increased white employment.<sup>20</sup>

In the U.S. Congress, in fact, during the debates preceding enactment of the first minimum wage law in the 1930s, many of its proponents argued that their key objective was to prevent southern blacks from competing for "white" jobs. They eventually succeeded. In the 1940s and early 1950s, before the minimum wage reached its current high level and wide coverage, black male teenage unemployment rates were lower than those for whites and their labor force participation rates were higher.<sup>21</sup> Today, the black male teenage unemployment rate is much higher than that of whites.

The effect of the minimum wage on black youths is tragic. By depriving many of them of the opportunity to reach the first critical rung up the economic ladder, it has denied them essential training and condemned them to a lifetime of unemployment and underemployment. Economist Martin Feldstein of Harvard explains:

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19. Walter E. Williams, The State Against Blacks (New York: McGraw-Hill, 1982), p. 40.

20. P. T. Bauer, "Regulated Wages in Under-Developed Countries," in Philip D. Bradley, ed., The Public Stake in Union Power (Charlottesville: University of Virginia Press, 1959), pp. 345-348. See also Walter Williams, "Minimum Wage--Maximum Folly and Demagoguery," Journal of the Institute for Socioeconomic Studies, Winter 1983-84, pp. 30-32.

21. Williams, The State Against Blacks, pp. 35-39. See also Walter Williams, "Government Sanctioned Restraints that Reduce Economic Opportunities for Minorities," Policy Review, Fall 1977, pp. 7-15.



At the root of this problem is the hard economic reality that firms cannot afford to offer useful on-the-job training to a broad class of young employees. A firm can generally provide the opportunity to acquire new marketable skills--by on-the-job training, detailed supervision, or even just learning by experience--only to a worker whose net product during the period of training is at least equal to his wage. Unfortunately, the current minimum wage law prevents many young people from accepting jobs with low pay but valuable experience. Those who come to the labor market with substantial skills and education need not be affected by the minimum wage. They are productive enough to permit employers to pay at least the minimum wage while also providing further training and opportunities for advancement. But for the disadvantaged young worker, with few skills and below-average education, producing enough to earn the minimum wage is incompatible with the opportunity for adequate on-the-job learning. For this group, the minimum wage implies high short-run unemployment and the chronic poverty of a life of low-wage jobs.<sup>22</sup>

Many liberals now accept the reality that minimum wage laws most penalize blacks.<sup>23</sup> This is certainly what prompts many black groups, such as the National Conference of Black Mayors, to support a lower minimum wage for teenagers. In the view of these organizations, the lower minimum wage would boost black youth employment.<sup>24</sup> Although Congress refuses to act on the reduced minimum--or youth opportunity--wage proposal of the Reagan Administration, recent estimates indicate that a minimum wage for youth that is one-quarter lower than the standard minimum would create between 250,000 and 430,000 jobs for teens.<sup>25</sup>

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22. Martin Feldstein, "The Economics of the New Unemployment," The Public Interest, Fall 1973, pp. 14-15. See also David T. Ellwood, "Teenage Unemployment: Permanent Scars or Temporary Blemishes," in Freeman and Wise, op. cit., and Masanori Hashimoto, Minimum Wages and On-the-Job Training (Washington, D.C.: American Enterprise Institute, 1981).

23. See, for example, Paul A. Samuelson, Economics, 7th ed. (New York: McGraw-Hill, 1967), p. 377.

24. Juan Williams, "Brock Backs Youth-Wage Trial," The Washington Post, May 7, 1985. See also "37% of Blacks Found in Favor of Lower Wage Floor," The New York Times, June 17, 1981.

25. Daniel S. Hamermesh, "Minimum Wages and the Demand for Labor," Economic Inquiry, July 1982, p. 378.

## CONCLUSION

Despite the mountain of evidence, many people cling to the idea that the minimum wage is good for all Americans.<sup>26</sup> The truth is that it does little good and much harm. For one thing, few Americans need the minimum wage to provide an acceptable living standard for their families. For another, the minimum wage pushes low-skilled Americans out of the job market.

There are not many Americans who must support themselves and their families on the minimum wage. In fact, almost all Americans earning close to the minimum wage are secondary workers--teenagers, working wives, and retired people--living in households along with workers who earn above minimum wages. As a consequence, there is virtually no connection between family incomes and wage rates. For this reason, most economic research concludes that the minimum wage does little to improve the distribution of income. Economist Edward Gramlich of the University of Michigan, for example, found that most of the "benefits" of a rise in the minimum wage actually go to upper-income families.<sup>27</sup>

The lost wages of those forced out of the labor market by a rising minimum wage of course also offsets the potential of the minimum wage to raise the incomes of the poor. Economist Marvin Kusters of the American Enterprise Institute estimates that, for every dollar earned by those who benefit from the minimum wage, 50 cents is lost by those harmed.<sup>28</sup>

Accepting this fact, The New York Times recently argued that the right minimum wage should be zero. "The idea of using a minimum wage to overcome poverty is old, honorable--and fundamentally flawed," the Times said. "It's time to put this hoary debate behind us, and find a better way to improve the lives of people who work very hard for very little."<sup>29</sup> Congress would do well to accept this judgment.

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26. See Sar A. Levitan and Isaac Shapiro, "The Working Poor Deserve a Raise," The New York Times, March 30, 1986, p. F2.

27. Edward M. Gramlich, "Impact of Minimum Wages on Other Wages, Employment, and Family Incomes," Brookings Papers on Economic Activity, No. 2, 1976, pp. 443-449. See also Carolyn Shaw Bell, "Minimum Wages and Personal Income," in Rottenberg, op. cit., pp. 439-458.

28. Marvin Kusters, "An Increase Would Hurt Teen-Agers," The New York Times, March 30, 1986, p. F2.

29. "The Right Minimum Wage: \$0.00," The New York Times, January 14, 1987.