

4/22/96

Number 275

THE FOLLY OF INCREASING THE MINIMUM WAGE

(Updating *Backgrounder* No. 1033, "Why Raising the Minimum Wage Is a Bad Idea," May 17, 1995.)

Congress once again is debating an increase in the minimum wage, this time from \$4.25 an hour to \$5.15. Although proponents argue that declining real wages require an increase to provide a decent living wage for low-income workers, a minimum wage hike in fact will harm unskilled Americans by destroying entry-level job opportunities.¹ Further, it will do nothing to increase the income of nonworking families, while raising prices for both the poor and non-poor.

Decreeing an increase in the minimum wage does not address the underlying cause of stagnant wages: slow productivity growth. Before raising the minimum wage, Congress must ask itself a fundamental question: Should it be illegal for Americans, young or old, to work at even a part-time job for \$4.50 or \$5.00 an hour?

While proponents make emotionally appealing arguments for raising the minimum wage, these arguments are misleading. To be sure, increasing the minimum wage will help some low-income workers, but it will have the opposite effect for many more Americans. It is also an inefficient way to boost the income of poor households. Among the reasons:

- X **Increasing the minimum wage to \$5.15 will harm the nonworking poor by raising prices and destroying over 200,000 entry-level job opportunities by 1999.** The minimum wage is an uncompassionate tax by which some low-wage workers increase their earnings while others lose their opportunity to earn anything at all. Raising it will effectively prohibit people from working unless their skills are worth at least \$5.15 per hour.
- X **Raising the minimum wage generally does not help low-income households.** The reason? Over half of the increased income from minimum wage jobs would go to youth and spouses living in families that are well-off, rather than to poor minimum wage workers.² Moreover, because almost half of minimum wage workers work *voluntarily* part time, many working only part year, 90 cents more per hour will not substantially increase their annual income but could cost them their jobs.

1 Mark Wilson, "Why Raising the Minimum Wage Is a Bad Idea," Heritage Foundation *Backgrounder* No. 1033, May 17, 1995. Many of the following data come from this study.

2 *Ibid.*

- X **Increasing the minimum wage does not help poor families because most do not have anyone working at the minimum wage.**³ Of the 23.5 million Americans in poor families, just over 2 percent are working and paid \$4.25 an hour.
- X **Hiking the minimum wage will cost consumers and workers about \$2.2 billion per year as the higher cost of entry-level jobs is passed on through higher prices and lower real wages.** Taxpayers will also be asked to shell out billions more for ineffective government training programs because the higher minimum wage has priced unskilled Americans out of the job market.⁴

Over the past 25 years, the United States has moved from a manufacturing to a global service economy, competition has increased, and more American women are working than ever before. Employers are straining under unnecessarily burdensome regulations, mandates, and taxes that have slowed productivity and limited real wage growth. But instead of addressing the impediments to wage growth imposed by government, proponents prefer to blame employers for stagnating wages and curry favor with voters by proposing another hike in the minimum wage.

Imposing another mandate that raises prices and destroys entry-level job opportunities, however, is not a compassionate or sensible response to the problem.

Instead of hiking the minimum wage, Congress and the Administration should focus on removing the barriers to productivity and wage growth that they have imposed on the private sector. Specifically, Congress and the Administration should:

- ✓ **Cut payroll taxes.** Studies also show that changes in legally mandated benefits are largely shifted to workers in the form of lower real wages.⁵ Cutting payroll taxes will directly increase take-home pay.
- ✓ **Cut the capital gains tax.** This will reduce investment disincentives, increase wages by raising productivity, and increase small business formation and associated job opportunities.
- ✓ **Balance the budget.** This will increase total domestic saving, lower interest rates, and increase investment. The growth in capital per worker is closely associated over time with the growth in labor productivity.
- ✓ **Increase the skills of the future workforce.** What is needed is fundamental change aimed at improving basic education through school choice and enabling local educators to strengthen core curricula, improve discipline, and set high expectations.
- ✓ **Increase the skills of the current workforce.** Enable employers to offer minimum wage apprenticeships that permit businesses to pay the minimum wage as a combination of cash and tax-creditable education.
- ✓ **Enact significant regulatory reform.** The explosion of new regulations since 1988 has raised the cost of labor and capital, creating barriers to the formation of new companies and jobs. The regulatory bureaucracy needs to be rolled back and job-killing labor regulations eliminated.

3 Ronald B. Mincy, "Raising the Minimum Wage: Effects on Family Poverty," *Monthly Labor Review*, July 1990, estimated that a 90 cent increase in the minimum wage may reduce the number of poor families by only 2.2 to 6.3 percent. Mincy also acknowledges that his model ignores changes in hours and prices and therefore overestimates the poverty-reducing effect of a higher minimum wage.

4 Mark Wilson, "Welfare Reform and Job Training Programs: What Congress Doesn't Know Will Cost Taxpayers Billions," Heritage Foundation *F.Y.I.* No. 61, August 16, 1995.

5 Jonathan Gruber and Alan B. Krueger, "The Incidence of Mandated Employer-Provided Insurance: Lessons from Workers' Compensation Insurance," National Bureau of Economic Research Working Paper No. 3557, December 1990.

INCREASING THE MINIMUM WAGE WILL DESTROY JOB OPPORTUNITIES

The vast majority of economists accept that raising the minimum wage will mean fewer job opportunities for lower-skilled workers. Using one of the nation's leading models of the U.S. economy, Heritage economists have estimated the effect of raising the minimum wage 90 cents an hour over the next two years on entry-level job opportunities.⁶ According to the Heritage analysis:

- X A 90 cent increase will cause employers to create over 200,000 *fewer* entry-level jobs each year by 1999, after which the impact declines. The rise in the minimum wage will increase the unemployment rate by at least 0.1 percentage points in 1998.
- X Prices will be at least 0.2 percentage points higher through 1998 as employers pass their increased costs on to both poor and non-poor consumers.

The minimum wage hurts unskilled Americans the most. A recent study by David Neumark at Michigan State University reveals that the significant negative effects on the employment prospects of unskilled teenagers are masked by their replacement in the work force by more highly skilled teens.⁷

- X The increase in the minimum wage proposed by President Clinton would increase the number of unskilled teens who are neither in school nor at work by almost 20 percent. Moreover, there is evidence that teens may actually drop out of school earlier in response to a higher minimum wage.

FACTS ABOUT MINIMUM WAGE WORKERS MISSING FROM THE DEBATE

For the most part, the 3.7 million workers who work at or below the minimum wage can be broken down into two broad groups.⁸

- ☞ **About half are teenagers or young adults age 21 or less**, and most (68.2 percent) of these young workers live in families with incomes two or more times the official poverty level for their family size.⁹ The average family income of a teenage minimum wage worker is around \$47,000. Only 12 percent of these young workers live in poor families.
- ☞ **The other half are workers ages 22 and up.** More of these workers live in poor families (27 percent or 367,000 have family incomes below the poverty level) or near poverty (44 percent have family incomes less than one and one-half times the poverty level). However, even among this half of the minimum wage population, 39 percent live in families with incomes two or more times the poverty level, and the average family income of minimum wage workers ages 25 to 61 is around \$25,000.

6 Heritage used the St. Louis-based Washington University Macro Model (WUMM) for this calculation. The model is widely used in the private sector to guide the business plans of *Fortune* 500 companies and in the public sector to estimate the economic implications of policy change. The St. Louis-based firm recently won the Blue Chip Consensus Forecasting Award for 1995. The methodologies, assumptions, conclusions, and opinions herein are entirely the work of Heritage Foundation analysts. They have not been endorsed by, nor do they necessarily reflect the views of, the owners of the WUMM.

7 David Neumark, "The Effects of Minimum Wages on Teenage Employment, Enrollment, and Idleness," Employment Policies Institute, August 1995.

8 David E. Rosenbaum, "The Minimum Wage: A Portrait," *The New York Times*, April 19, 1996, p. A26.

9 Wilson, "Why Raising the Minimum Wage Is a Bad Idea." The poverty rate in 1994 was \$7,543 for a single person and \$15,148 for a family of four.

- ☛ **Only 23 percent of minimum wage workers were the sole breadwinners in their families in the previous year.**¹⁰ The wage and salary earnings of 56 percent of minimum wage workers account for 25 percent or less of their families' total wage and salary income.
- ☛ **Only 16 percent of minimum wage workers are full-year, full-time employees.** Thirty-three percent are part-year, part-time employees, and almost half (48.5 percent) are *voluntary* part-time workers.¹¹
- ☛ **Almost 40 percent of the sole breadwinners earning the minimum wage are voluntary part-time workers,** while only 18.8 percent of all minimum wage workers are family heads or spouses working full time.¹²

It is incorrect to portray entry-level minimum wage jobs as lifetime dead-end jobs. Instead they should be recognized as opportunities for most people to establish a track record of work and a springboard to better paying jobs. More than 60 percent of all workers can point to a minimum wage job as their first job experience.¹³ Some 40 percent of workers starting a minimum wage job will receive their first raise within 4 months, and 63 percent of those workers will be earning 20 percent more than the minimum wage within 12 months.¹⁴ George McGovern put it best when he said, "We forget that too often a job—any job—is the best training for a better or more specialized job."¹⁵

THE MINIMUM WAGE DESTROYS ECONOMIC FREEDOM AND INCREASES GOVERNMENT DEPENDENCE

Before raising the minimum wage, Congress must ask itself two fundamental questions: Should it be illegal for Americans, young or old, to work at even a part-time job for \$4.50 or \$5.00 an hour? And does the federal government have the right to destroy the economic freedom of families by telling parents that their young son or daughter may not work this summer for \$4.50 an hour, or that a senior citizen may not work part-time for \$5.00 an hour next year?

Proponents defend a minimum wage increase by declaring it to be a moral issue and a moral imperative—not just an economic or political consideration. The minimum wage, however, epitomizes government paternalism at its worst. It presumes that politicians are morally justified in destroying some people's jobs in order to inflate other people's wages. The American principle of economic freedom has been replaced by the principle of "government knows best." Decreeing a higher minimum wage without mandating that every American be given a job just knocks the bottom rung off the economic ladder and denies millions their opportunity to begin pursuing the American Dream.

The state of Oregon, in a brief to the U.S. Supreme Court defending its 1917 minimum wage law, revealed the actual implications of such laws: "If Simpson [a woman thrown out of work by the Oregon law] cannot be trained to yield output that does not pay the cost of her own labor, then she can... accept the status of a defective to be segregated for special treatment as a dependent of the state."¹⁶

10 Families here refers to the traditional meaning—parent(s) with children—and does not include single family heads with no children.

11 Heritage Foundation tabulations from March 1994 Current Population Survey.

12 Heritage Foundation tabulations.

13 David Card and Alan Krueger, *Myth and Measurement: The New Economics of the Minimum Wage* (Princeton, N.J.: Princeton University Press, 1995).

14 Ralph E. Smith and Bruce Vavrichek, "The Wage Mobility of Minimum Wage Workers," *Industrial Relations and Labor Review*, Vol. XLVI, No. 1 (October 1992), pp. 82-88. 20 percent is the median increase for those workers.

15 Dick Arney, *The Freedom Revolution* (Washington D.C.: Regnery Publishing, Inc., 1995), p. 238.

16 James Bovard, "How Fair Are the Fair Labor Standards?" *Regulation: The Cato Review of Business & Government*, Vol. 18,

Government must share the blame for stagnant wages. Over the years, more and more mandates, higher and higher taxes, and overregulation have shackled the economy, limited productivity, and stagnated real wage growth.¹⁷ Employers do not—indeed cannot—unfairly keep down the wages of their lower-skilled and entry-level employees. Employers, as well as workers, operate within a competitive labor market in which wage rates broadly reflect the productivity of workers—*less* the costs of government-imposed mandates and taxes associated with employing a worker. But instead of addressing the impediments to wage growth imposed by government, proponents prefer to blame employers for stagnating wages and curry favor with voters by proposing another hike in the minimum wage. Imposing another mandate that raises prices and destroys entry-level job opportunities, however, is not a compassionate or sensible response to the problem.

CONCLUSION

Raising the minimum wage appeals to the sense of decency and compassion of Americans. But it would be a mistake. Increasing the minimum wage would impose significant costs, primarily on those unskilled Americans a minimum wage hike is supposed to help. It also would raise prices for both the poor and non-poor. It would destroy entry-level job opportunities that otherwise would have been created, and although it could raise some workers' family incomes above poverty, it would do so at the cost of denying jobs to many more workers.

To raise the standard of living of minimum wage workers without imposing these costs, Congress should focus on policies that would raise worker productivity while reducing government-imposed labor costs on employers.

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No. 1 (1995).

¹⁷ Olivia S. Mitchell, "The Effects of Mandating Benefits Packages," National Bureau of Economic Research Working Paper No. 3260, February 1990; Wayne B. Gray, "The Cost of Regulation: OSHA, EPA and the Productivity Slowdown," *American Economic Review*, Vol. 77, No. 5 (December 1, 1987); Thomas D. Hopkins, "The Cost of Federal Regulation," *Journal of Regulation and Social Costs*, Vol. 2, No. 1 (March 1992).

