

WebMemo



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Postpone Minimum Wage Increase until Low-skilled Unemployment Falls

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On July 24, the minimum wage increase Congress passed two years ago will enter its final phase, increasing the cost of hiring unskilled workers by 10 percent. Economic research demonstrates that higher minimum wages come at the cost of higher unemployment for low-skilled workers, but when Congress passed the minimum wage increase unemployment was low. Now, in the middle of a deep recession, unemployment has risen sharply for the least skilled workers. Wage growth has flattened since the start of the year. This minimum wage increase will artificially increase costs for struggling businesses at exactly the wrong time. And as a result, it will cost 300,000 teenagers and young adults their jobs.

Even advocates of a higher minimum wage should recognize that a recession is the wrong time to enact such legislation. Congress should postpone this minimum wage increase until the unemployment rates of teenagers and unskilled adults return to historically normal rates.

Minimum Wage Increase Passed in Strong Economy. In 2007, Congress voted to increase the minimum wage, raising it in three \$0.70 increments from \$5.15 to \$7.25 an hour. The first increase took place in July 2007, the second in July 2008, and the final increase will take effect on July 24, 2009. This final installment represents a 10 percent increase in the cost of hiring minimum wage employees.

The economy seemed healthy at the time that Congress passed the increase. Unemployment was below 5 percent. Since then the economy has

slipped into a deep recession and unemployment has doubled to nearly 10 percent. Unemployment among the least skilled workers has jumped by an even larger amount. Congress should reconsider this minimum wage increase in light of the recession.

Minimum Wage Maximizes Unemployment. Congress trades off higher minimum wages against increased unemployment in all economic conditions because the true minimum wage is zero. Businesses will not hire workers whose labor produces less than the cost of hiring them. Employers will not pay \$7.25 an hour to hire a worker whose hourly efforts bring in only an additional \$7.00. Consequently, higher minimum wages price some less-skilled workers out of work. While some workers will get a raise, others will lose their jobs.

Most minimum wage research confirms this effect: Two-thirds of recent minimum wage studies find that it reduces employment, with the overwhelming majority of the most rigorous studies reaching this conclusion.¹

Although individual studies give different estimates, the typical results from research suggest that a 10 percent increase in the minimum wage will reduce employment among heavily affected groups

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of workers by roughly 2 percent. One study found that each 10 percent increase would cost 1.2 percent to 1.7 percent of low-income workers their jobs.² Another study found that in the long term, a 10 percent increase in the minimum wage reduces teenage employment by 2.7 percent.³

These estimates show that—under normal economic circumstances—this scheduled increase will cost 300,000 teenagers and young adults their jobs.⁴

Businesses Cannot Afford Higher Costs Now.

The current fiscal climate however, does not constitute “normal” economic circumstances. The economy is in a sharp recession, and most employers do not have the profits to pay higher wages. Nor can they pass costs on to consumers by raising prices, because Americans have become particularly budget conscious.⁵ Average wages did not grow in the last quarter.⁶

The minimum wage increase amounts to an artificial 10 percent increase in the cost of hiring unskilled workers. Businesses always respond to higher costs by economizing, but they are especially sensitive to higher costs now. They will respond to this minimum wage hike by trying to reduce their overall payroll costs as much as possible. They will reduce hours and cut even more jobs than would be expected in normal economic times. Wage growth has flattened since the start of the year because employers cannot afford to pay more.

Unemployment Spiking for Less Skilled Workers. The government should not discourage businesses from hiring unskilled workers right now. Whatever the debate over raising the minimum wage in normal times, unskilled workers cannot

afford another 300,000 job losses now. Chart 1 shows the overall unemployment rate and the unemployment rate for teenagers and adults without a high school diploma and adults with a bachelor's degree or higher. Unemployment has increased much more rapidly for less skilled workers than for Americans as a whole.

The overall unemployment rate has risen 4.5 percentage points since the start of the recession. However, the unemployment rate for workers most affected by the minimum wage—teenagers and less educated adults—has risen at a much faster rate. Unemployment among teenagers has risen 6.4 percentage points to 22.7 percent. The unemployment rate for adults without a high school diploma has risen 7.8 percentage points to 15.3 percent. However, the unemployment rate for workers with a bachelor's degree or higher—almost none of whom earn the minimum wage—has only risen by 2.5 percentage points. Less-skilled workers have borne the brunt of job losses in the recession. Now is the wrong time to put another 300,000 employees out of work.

First Rung on a Career Ladder. Putting 300,000 employees out of work would be particularly painful because minimum wage jobs provide unskilled workers with the opportunity to gain experience and become more productive. Few workers start at the minimum wage and stay there for decades. Rather, most minimum-wage jobs are entry-level positions and are typically taken by low-skilled workers with little workforce experience. Fully 40 percent of minimum-wage workers did not have a job in the previous year.⁷

1. David Neumark and William Wascher, “Minimum Wages and Employment,” *Foundations and Trends in Microeconomics*, Vol. 3, Nos. 1–2, 2007, pp. 1–182, at http://www.socsci.uci.edu/~dneumark/min_wage_review.pdf (July 23, 2009).
2. David Neumark, Mark Schweitzer, and William Wascher, “The Effects of Minimum Wages throughout the Wage Distribution,” *The Journal of Human Resources*, Spring 2004, pp. 425–450.
3. Stephen Bazen and Velayoudom Marimoutou, “Looking for a Needle in a Haystack? A Re-Examination of the Time Series Relationship between Teenage Employment and Minimum Wages in the United States,” *Oxford Bulletin of Economics and Statistics*, Vol. 64, Supplement (2002), pp. 699–725.
4. David Neumark, “Delay the Minimum Wage Hike,” *The Wall Street Journal*, June 12, 2009, at <http://online.wsj.com/article/SB124476823767508619.html> (July 23, 2009).
5. Lisa Scherzer, “Winners and Losers of the Minimum Wage Hike,” *The Wall Street Journal*, July 10, 2009, at <http://online.wsj.com/article/SB124724104591224049.html> (July 23, 2009).
6. Department of Labor, Bureau of Labor Statistics, “Establishment Survey.”

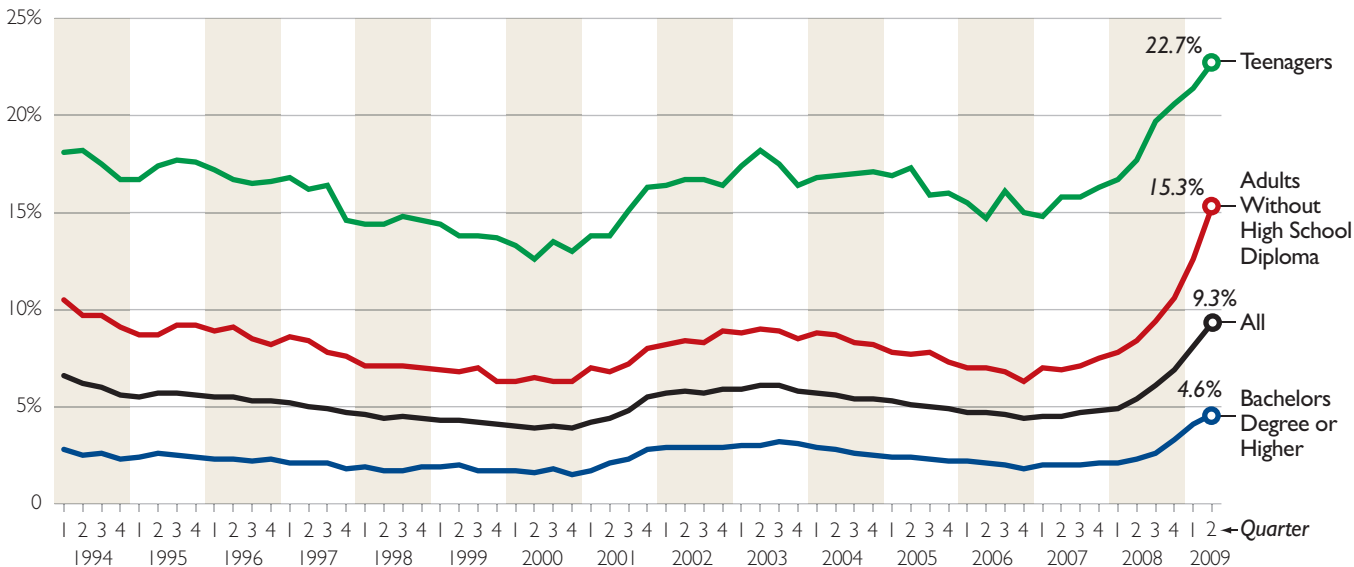
Unemployment High Among Unskilled Workers

The unemployment rate among adults without a high school degree has increased by 7.8 percentage points from the fourth quarter of 2007 to the second quarter of 2009.

Change, Q4 2007 to Q2 2009 (Percentage Points)

Teenagers	+6.4
Adults Without High School Diploma	+7.8
All Workers	+4.5
Bachelors Degree or Higher.....	+2.5

Unemployment Rate For Various Groups Since 1994



Notes: Teenagers are 16-19 year olds and the high school dropouts are 25 years of age or older. Data shown is quarterly to smooth out the statistical fluctuations that occur in the smaller sample sizes for the these subgroups of the population.

Source: Department of Labor, Bureau of Labor Statistics / Haver Analytics.

Chart 1 • WM 2557 heritage.org

Minimum-wage jobs teach these workers valuable job skills, such as how to interact with customers and co-workers or accept direction from a boss—expertise that is difficult to learn without actual on-the-job experience. Once workers have gained these skills, they become more productive and earn higher wages. Two-thirds of minimum wage workers earn a raise within a year.⁸ Minimum-wage jobs provide valuable work experience that leads to higher-paying jobs—or that, during a recession, are needed to find employment. The minimum wage increase will saw off the bottom rung of the career ladder for many unskilled workers.

Postpone Minimum Wage Increase. Already facing weak demand and flattening wage growth, businesses cannot afford an artificial 10 percent increase in their labor costs. Even supporters of raising the minimum wage should recognize that the government should not stimulate job losses in the middle of a recession. Congress should postpone the minimum wage increase until unemployment among the most affected workers returns to normal levels.

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7. David Macpherson and William Even, “Wage Growth among Minimum Wage Workers,” Employment Policies Institute, June 2004, p. 3, at www.epionline.org/studies/macpherson_06-2004.pdf (July 23, 2009).

8. *Ibid.*, pp. 3 and 5, Table 1. Wage figures are adjusted for inflation.