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spotlight

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The Minimum Wage Effect

'One Dollar More' Means More Unemployed

SUMMARY: **State Treasurer Richard Moore wants to raise the minimum wage in North Carolina to $6.15, "one dollar more" than the federal minimum wage. Moore says the minimum wage hike would help those at the lowest rung of the economic ladder. That's counter to even basic economics. Studies show that raising the minimum wage makes it *even harder* for the lowest skilled workers to find employment — but those are the very people it's supposed to help. Ironically, minimum-wage hikes benefit middle- and upper-income families the most.**

In a recent speech delivered to a conference of the North Carolina Citizens for Business and Industry (NCCBI) State Treasurer Richard Moore endorsed the idea of raising the state's minimum wage to "at least" $6.15 per hour. This would be $1.00 above the federally mandated minimum of $5.15. Toward this end he has started a campaign that he has dubbed "the one dollar more" coalition to push for the wage hike. Moore claims that this boost in the minimum wage would give those at the lower end of the economic ladder "the opportunity to improve their situation and that of their families." While Moore's logic might seem straightforward — *if you want people to take home a higher wage, simply force employers to pay them more* — basic economics suggest that this is an approach that actually makes conditions worse for those who are supposed to be helped.

The "Moore Effect": Unemployment

The myth that Moore and many others buy into is that people's wages can simply be raised by government decree without any change in workers' productivity. In other words, he assumes that there is no direct relationship between wages and productivity. Indeed, it is assumed that even if the cost of hiring a worker is greater than the value of the production he is capable of generating, employers will hire him anyway. Maybe that is how things work in Moore's Treasury Department, where profits do not have to be earned and revenue shortfalls can be made up for with higher taxes, but in the private sector there is no taxpayer trough to draw from.

Recent empirical estimations by two Duke University economists suggests

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that for each increase of 10 percent in the minimum wage there will be a 2.9 percent decrease in the likelihood that a low skilled worker will find employment.[1] For "one dollar more" the tradeoff will be a *5.5 percent decline* in the chances that a low-skilled worker will find employment. This means that for those low-skilled workers who start out severely disadvantaged in the marketplace, this is just "one more" obstacle placed in their path.

The economic theory behind these conclusions is not difficult to understand. In fact it would be irrational for any employer to hire someone whose work skills are so low that the value of their productive efforts is below the full costs of hiring him. This unemployment effect would become quite clear if we raised the minimum wage to $100 per hour. It would then be obvious that hundreds of thousands of people would lose their jobs as the economic value of their skills and capabilities fell below the mandated minimum. Most of us would be against such a law because we know that we would lose our jobs immediately. The increase in the minimum wage proposed by Mr. Moore would have the same effect, but the impact would fall on a narrower group, namely the most disadvantaged among us.

For someone employed at $6.15/hour, the full cost to the employer would be, at minimum, close to $7.00/hour including payments for Social Security and Medicare. The hourly cost could climb considerably if there were employer-provided health insurance or other benefits. But taking the lower minimum amount, anyone whose skills are such that they cannot provide greater than $7.00/hour's worth of service to an employer would not be able to find work. Especially vulnerable would be teenagers and minorities, particularly African American males, who tend to be underserved by the public education system.

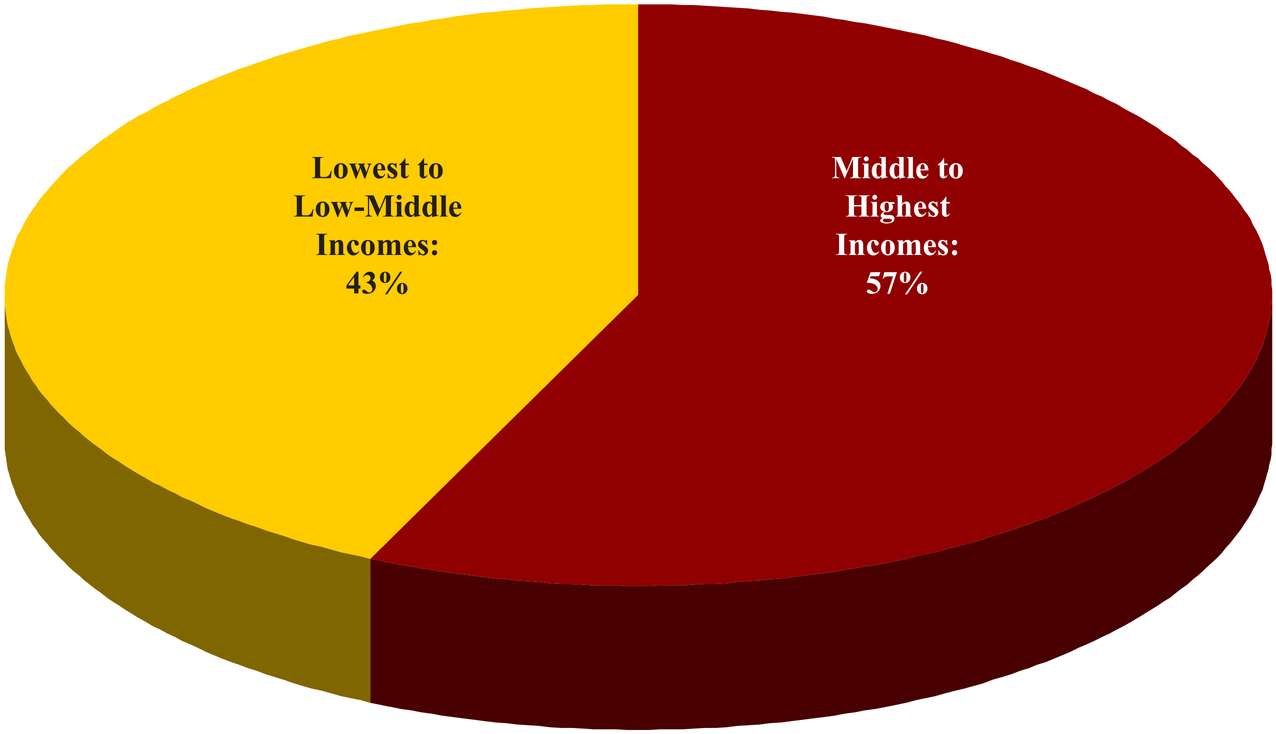
It is actually cruel for the state to provide someone with a substandard education and then set a minimum wage that prevents that person from finding a job. First they are left behind by the public school system, and then they are blocked from obtaining an entry-level job where they can gain valuable work experience. Without the educational background, they need the work experience offered by entry-level jobs, which they would be effectively barred from obtaining. Consequently, the possibility of moving into higher-paying positions as their skills and experience improve is also denied. This one-two punch of a poor education and a minimum wage cuts off the bottom rung of the economic ladder for many disadvantaged young people.

The Card and Krueger Study

In a recent survey of American Economic Association labor economists, over 80 percent agreed that minimum-wage increases would cause employment losses.[2] Indeed, there are very few issues like the effects of minimum wages over which economists, notoriously in disagreement with one another, come together so consistently. In spite of this there are dissenters. The study most widely cited by advocates of higher minimum wages, such as labor unions and left-wing advocacy groups, was published in the *American Economic Review* by economists David Card and Alan Krueger (C&K).[3] These authors examined employment in the fast food industry in adjacent areas of New Jersey and Pennsylvania before and after a minimum-wage increase that applied only to New Jersey. Their results seemed to clash with the standard theory. They argued that not only did the mandated wage increase in NJ not cause increased unemployment, they concluded that it actually coincided with an increase in employment at these minimum-wage-paying eating establishments. Since its publication, advocates of higher minimum wages have touted this study as evidence that the standard analysis is wrong. After the study was published, President Clinton stated "I believe the weight of the evidence is that a modest increase does not cost jobs."[4]

While this research has been and continues to be widely cited by media outlets and advocacy groups, it has been *roundly repudiated in the economics profession*, including in the *American Economics Review*, where the study first appeared. In a study by economists David Neumark and William Wascher published in 2000,[5] the authors first criticized C&K's data collection technique and then did a reanalysis. They pointed out that C&K gathered their information about employment in the fast food industry by using phone interviews with store managers. This method of information gathering is notoriously unreliable, primarily because it relies on personal memories and impressions. Also, in conducting the surveys C&K did not precisely define the relevant time frame. As Neumark and Wascher point out, "the employment data they collected are as of the interview date, but do not cover a precisely defined time interval."[6] These authors go on to use the same restaurant chains and the same econometric model as C&K, but they replace their

Figure 1: Distribution of Additional Earnings from Minimum-Wage Increases, by Family Income



Source: MaCurdy and McIntyre, "Winners and Losers of Federal and State Minimum Wage"[10]

survey data with actual payroll data from the companies. Neumark and Wascher's conclusions are exactly opposite of those reached by Card and Kruger.

> CK's data imply that the New Jersey minimum wage increase (of 18.8 percent) resulted in an increase of fast food employment of between 11 percent and 16.8 percent relative to Pennsylvania. ... In contrast a simple replication of CKs ... estimation using the payroll data indicates that the New Jersey minimum wage increase led to a 3.9-percent to 4.0-percent decrease in fast-food employment in New Jersey relative to the Pennsylvania control group.[7]

In should be noted, by those who think that Moore's proposal is too small to have an impact on employment, that while New Jersey's increase at that time was 18.8 percent, Moore's proposal is for a 19.4 percent increase.[8]

So Who Benefits?

Everyone doesn't lose from minimum wage increases, only those who are the least experienced and least skilled. These are the people that supporters of higher minimum wages claim to be most concerned about. There is no question that increases in the minimum wage benefit middle and upper income families the most.

Stanford University's Thomas MaCurdy and Frank McIntyre looked at the academic literature addressing this subject, and the results were quite consistent.[9] They found that typically 55 to 60 percent of the benefits from the minimum wage go to workers from middle- to upper-income families. In their own research they found that 57 percent of workers that benefit from the minimum wage live in families from those these higher income categories (see Figure 1).

Again, this is consistent with economic analysis. First many of the lowest skilled workers are actually deprived of employment as increases in the minimum wage cut short their entry into the work force. In addition, as the minimum wage is increased, potential employees from families with higher incomes, such as college students who would be better educated and more skilled, find the higher minimum wage more attractive and enter the job market. This income-transfer effect of minimum wage increases lend a whole new meaning to the phrase “upward mobility.”

Conclusion

If the goal of increasing the minimum wage is to help those on the bottom end of the economic ladder or, more importantly, those who are not on the ladder, then State Treasurer More’s plan is doomed to failure. There is no theoretical or empirical evidence to support such a policy. The only way to increase wages for workers is to make their skills worth more in the marketplace. This will happen when North Carolina takes serious steps to improve its high school dropout rate and to improve the state’s public education system, which fails to prepare the least advantaged in our society for a productive work life. To use a potential hike in the minimum wage as a way of promising a better life for unskilled, uneducated, and inexperienced workers is equivalent to perpetrating a cruel hoax.

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Notes

1. Peter Arcidiacono and Tom Ahn, “Minimum Wage and Job Search: What Do Employment Effects Really Measure?” Employment Policy Institute, August 2004, found at http://www.epionline.org/study_detail.cfm?sid=75
2. “The Living Wage: Survey of Labor Economists,” The Survey Center, University of New Hampshire, http://www.unh.edu/ipssr/survey-center, August 2000. Survey published by the Employment Policies Institute at www.epionline.org.
3. David Card and Alan Krueger, “Minimum Wage and Employment: A Case Study of the Fast Fodd industry in new Jersey and Pennsylvania,” *The American Economics Review*, Vol. 84, No. 4, 1994, pp. 772-793.
4. As quoted in Benjamin Zycher, “Flawed studies drive the call for an increased minimum wage,” found at http://reason.com/9506/zycher.jun.shtml
5. David Newmark and William Wascher, “Employment Effects of Minimum and Subminimum Wages,” *The American Economic Review,* Vol. 90, No. 5, 2000, 99.1362-1396.
6. *Ibid*. p. 1363.
7. For an excellent summary of the academic refutations of C&K’s work see Dr. Thomas MaCurdy and Frank McIntyre, “Winners and Losers of Federal and State Minimum Wages” published by the Employment Policies Institute, found at http://www.epionline.org/study_detail.cfm?sid=24
8. *Ibid.*
9. *Ibid.*
10. *Ibid.*