

Minimum Wage + \$1 = More Poverty

Fortune, October 1998

Amazing fact: Even as you read this--even as each new stanza of that bizarre epic, the Clintoniad, is written--there are politicians in Washington actually trying to change, you know, laws. It's true, and in the case of minimum wage policy, it's unfortunate. When they're not distancing themselves from the President, Democrats in Congress are quietly agitating to raise the minimum wage from \$5.15 to \$6.15 over the next two years and will probably try to attach a higher minimum to a spending bill this fall.

The minimum wage is a bad idea that keeps coming back, despite the efforts of economists everywhere to kill it. The vast majority of economists oppose the minimum wage on the grounds that it destroys jobs for unskilled workers. For every 20% increase in the minimum wage, most economists believe, employment of teenagers and young adults falls by about 2% to 4%. A new study published by the National Bureau of Economic Research in Cambridge, Mass., enormously strengthens the economists' case against the minimum wage. The study, done by David Neumark of Michigan State University, Mark Schweitzer of the Federal Reserve Bank of Cleveland, and William Wascher of the Federal Reserve Board of Governors, finds that increases in the minimum wage also increase the number of families below the poverty line.

One common justification for raising the minimum wage is that since the ensuing job loss is so small, it's a good way of increasing the income of the unskilled, many of whom are in poor families. In other words, if a 20% minimum wage increase throws only 2% of youths out of work, doesn't that mean that the other 98% get a 20% pay increase? Actually, no. Neumark et al. point out that in the real world, when the government raises the minimum wage, the majority of youths are usually earning well above the new minimum, so most youths will see little or no pay increase after the wage hike. If the minimum goes up, only those who had been earning less than the new limit could possibly enjoy a raise.

In fact it is these very low-paid youths--who are supposed to benefit from a wage hike--who suffer the job losses, as the study illustrates with wage data from 1995,

before the minimum wage went from \$4.25 to \$5.15. In that year there were 19 million workers ages 16 to 24, of whom about four million earned somewhere between \$4.25 and \$5.14, and therefore stood to receive raises. Now apply the minimum wage/job loss ratio described above and use the low end of the consensus estimate--that a 20% increase in the minimum wage reduces youth employment overall by at least 2%. Since the 1995 case involved a 21% minimum wage hike, about 2%, or 380,000, of all young workers lost their jobs. But when you focus only on the 4 million workers directly affected by the wage hike, the tradeoff looks a lot worse: 380,000 jobs now translates to 9%.

The study also looks at state governments, which sometimes impose their own minimum wages. Neumark et al. use census data to estimate the effects on family income when a state's minimum wage is set above the federal minimum. They find that within a year of an increase in a state's minimum wage, there was a 4.5% increase in the number of families with incomes below the poverty level. So the net effect of increasing the minimum wage has been to increase poverty rather than to decrease it.

Why would this effect occur a year after the minimum wage increase rather than right away? For two reasons. First, when the minimum wage increases, employers take time to adjust their methods of production. That is to say, it takes time for fast-food joints to buy new burger-flipping machinery that requires one teenager to operate rather than two. Second, low-wage jobs turn over quickly, so employers who don't like firing (i.e., most of them) tend to wait for turnover and attrition to do the job for them.

In answer to the usual leftish defense of the minimum wage as a boon to the urban poor, liberal MIT economist Paul Samuelson once asked, 'What good does it do a black youth to know that an employer must pay him \$2 an hour if the fact that he must be paid that amount is what keeps him from getting a job?' The problem isn't raising the minimum wage; the problem is, and always has been, the minimum wage itself.