THE MINIMUM WAGE

Congress should

- repeal the federal minimum wage; and
- using its authority under the Commerce Clause, prohibit state and local governments from establishing minimum wages.

State and local lawmakers should

- repeal state and local minimum wage laws.

The “Fight for $15” movement has generated momentum in the past 13 years, with many states aggressively increasing their minimum wage rates and a $15 per hour federal minimum wage close to obtaining the political support necessary for congressional passage.

Supporters of higher minimum wages argue that they are necessary to boost living standards for the working poor. Opponents have traditionally responded that minimum wage hikes would harm critical entry-level employment opportunities for low-skilled and inexperienced workers. As possibly the most studied economic policy issue, both sides can cite economic theories and empirical studies to back their positions.

Yet, despite claims to the contrary, the preponderance of the scholarly literature remains on the critics’ side. A recent University of Chicago Initiative on Global Markets poll of leading academic economists found that 50 percent agreed with the statement that “a federal minimum wage of $15 per hour would lower employment for low-wage workers in many states,” with only 16 percent disagreeing. Newer lines of research establish that a higher minimum wage can harm the public welfare in other, less discernible ways too.

This chapter, therefore, argues that, far from minimum wages being increased, minimum wage laws should be *repealed*. For their mutual benefit, laborers and employers should be free to strike voluntary work agreements at any wage rate.

Economic Theory

Both supporters and critics of minimum wage laws cite classical price theory—the interaction of supply and demand—to support their positions. They differ, however, on important assumptions about real-world conditions: specifically, whether employers have significant "market power" over labor pools such that businesses can pay wages below competitive market rates.

The standard competitive model of the labor market assumes there are many potential workers and businesses seeking out labor. These "consumers" and "suppliers" of labor decide whether to buy and sell based on the price they would pay or receive for work: if the wage rate is too high, businesses will buy less labor, and if it is too low, fewer workers will make themselves available. Such decisions result in an equilibrium wage and quantity of labor exchanged in the market.

The model predicts that a minimum wage enforced at a level above the market-determined equilibrium creates unemployment: the quantity of labor supplied rises due to the higher wage on offer, but the quantity of labor demanded falls given the higher wage costs to firms. Some jobs simply aren't profitable enough, or labor isn't valuable enough, for businesses to justify paying the minimum wage plus other costs that employers must bear for workers (e.g., payroll taxes, training costs, health care and other benefits, and liability insurance).

The standard model expects the least productive or experienced workers to be the ones most likely to be laid off, have their hours cut, or find it more difficult getting hired when a minimum wage is set at a high level. That means the loss of crucial work experience or opportunities to learn soft skills and accumulate on-the-job human capital from employment. The banning of mutually beneficial trades—of would-be employees willing to work for wage rates that employers are happy to pay—makes us poorer as a society while also harming many of the workers this policy intends to help.

The theoretical argument that minimum wages are actually good for efficiency stems from the idea that low-wage labor markets are not competitive but "monopsonistic." This view says that businesses hold enough power over workers to pay lower wages when they hire fewer of them, such that the benefit from lower labor costs outweighs the cost of forgone output and revenue. If a market exists where employers have such market power, a minimum wage carefully set to bring the wage rate closer to a competitive market level can provide the double dividend of higher hourly wages *and more* employment. There is no tradeoff between raising pay and jobs, at least provided that minimum wages are not increased beyond the competitive wage rate.

Empirical Evidence

Both theories are prima facie plausible. They are also empirically testable. If minimum wage supporters are correct, increasing the wage would increase employment; if critics are correct, raising the minimum wage would result in *less* employment (whether that manifests through fewer jobs or hours worked).

Minimum wage supporters frequently cite a 1994 paper by economists David Card and Alan Krueger as evidence in their favor. That paper found that a 1992 New Jersey minimum wage increase resulted in higher fast-food restaurant employment in that state's side of the Philadelphia metropolitan area relative to the Pennsylvania side. Yet this paper itself was soon challenged by other academics on data grounds and is not representative of the academic literature as a whole.

In a recent meta-analysis, economists David Neumark and Peter Shirley assembled the entire set of papers examining the impact of minimum wage hikes at the state and local level since 1992. Just 5.8 percent of those studies found that minimum wage hikes increased employment. The overwhelming majority (79.3 percent) found that hikes had a negative effect, with the impact stronger for teens, young adults, and less-educated workers. Perhaps unsurprisingly, economists Jeffrey Clemens and Michael Strain have found that large minimum wage hikes have significantly larger negative effects than small hikes.

It's certainly true that a significant minority of studies, particularly those assessing the impact of modest minimum wage hikes in growing economies, have found little overall impact on jobs. A lot of these results hinge on methodological choices, such as time frames or industries examined, and how one defines the counterfactual—that is, what control groups are used to judge the impact of the policy.

Studies on impacts on the retail and restaurant industries have been less likely to find immediate negative effects from minimum wage hikes, for example. But those examining broader changes to employment rates in the longer term—job growth—have tended to find much larger harmful effects from minimum wage increases.

The fairest assessment of the empirical literature is that very few studies find that minimum wages boost employment and that a significant minority find no to small employment effects. But the majority of papers find negative effects that are larger for low-skilled workers and during downturns.

Non-Wage Impacts of Minimum Wage Hikes

Not every business will react to a minimum wage hike by laying off workers, reducing its hiring, or cutting worker hours. But unless there is a costless way that companies can use the wage hike to improve worker productivity, these other adjustments harm a business's bottom line or else lead to adverse effects for the worker that aren't picked up by studies assessing the simple pay-employment tradeoff.

Some companies will pass some or all the minimum wage increase onto consumers via higher prices, for example. A recent study by economists Orley Ashenfelter and Štěpán Jurajda examining how McDonald's reacted to minimum wage hikes found evidence "consistent with near-full price pass-through of minimum wages in McDonald's restaurants." The ability to do this will depend on the industry and its competitive conditions, and this certainly doesn't occur across the board. But if minimum wage hikes raise the cost of certain products, such as takeout foods and hospitality services, this will reduce the real income gains that low-income households with minimum wage workers might expect from the wage hike.

Other companies will tough it out in the short term by bearing the higher labor costs through reduced profits. But that's not economically costless at the economy-wide level either. Weaker profits will increase the likelihood of firm deaths, thus risking jobs. A study of Yelp data, for example, found that minimum wage increases in San Francisco predict increases in exit among low-rated restaurants. Lower profit rates will discourage business startups and firm entry, reducing future job opportunities or consumer welfare. Again, there is no free lunch.

Given that businesses are not charities, it is more likely they will adjust on other margins, such that the pay gains for workers are offset by other changes to their compensation or work conditions. Non-wage aspects of jobs that can be costly to firms, such as the convenience of schedules, security of work hours, health insurance quality, retirement benefits, payments-in-kind, and workplace conditions are important to workers.

The economic literature on these adjustments is less advanced. But analyses of more recent minimum wage changes tend to find negative effects of minimum wage hikes on the generosity of the employer-funded health insurance they are offered. Evidence from the retail sector suggests that companies have reduced employees' work hours, making them ineligible for other in-work benefits as a means of better controlling labor costs when the minimum wage was raised. Fast-food outlets have likewise reduced generosity by stripping their staff of free food benefits after major minimum wage hikes. Other research finds minimum wage hikes make it more likely companies find other ways to control their labor costs (such as unusual contracts that do not guarantee set hours) or keep workers more attached to firms (such as non-compete provisions in contracts).

Finally, some businesses will react to higher mandated pay by trying to improve the productivity of their workforce. But this is not costless either.

Raising productivity may require replacing inexperienced low-skilled employees with more experienced employees, or else investing in labor-saving devices. These bring search, turnover, and upfront "lumpy" costs while still reducing work opportunities for lower-skilled workers. Raising productivity might also entail requiring more effort of workers by imposing ambitious targets or stripping away work breaks. That may raise their output to justify the higher wage but at the same time make their work more stressful or unpleasant, which represents a decline in their quality-adjusted wage.

The Minimum Wage as Social Policy

Given the empirical evidence, some minimum wage supporters concede that, yes, these laws might reduce job opportunities or have other unintended consequences. But, they say, the lost jobs or hours are a worthwhile tradeoff for higher wages for low-skilled workers who remain employed, thereby reducing poverty.

Although the Congressional Budget Office has indeed found that a $15 per hour minimum wage probably would reduce the level of poverty somewhat, it would be a far blunter tool than its proponents imagine.

First, those with the lowest skill levels are the most likely to be made unemployed or find it more difficult to get a first job due to minimum wage hikes, which risks more entrenched poverty. David Neumark's research has found that high minimum wage rates when young scars the labor market prospects for lower-paid black workers in particular.

Second, a lot of people who earn the federal minimum wage, or just above it, are not members of *households* that are poor. They might be working students or second earners in relatively affluent households who are working part time.

Third, a lot of the cost pass-through into consumer prices will tend to occur for products that the poor buy disproportionately or which might affect them most harshly—for instance, fast-food or labor-intensive services such as home-based childcare.

A full picture of the distributional aspects of the minimum wage would need to account for all this rather than just looking at the impact on earnings for those who maintain their jobs or hours. But no aggregated analysis will be able to account for the multitude of effects on individuals, given their very different circumstances and life opportunities.

Minimum wage hikes will no doubt raise incomes for many, but they also raise risks of fewer work opportunities for teenagers who want an after-school job, first-time workers who are willing to "pay their dues" to pursue higher ambitions, young workers with low living costs, idealists who will accept a low wage to work for a cause, and people who want to make a little money while helping an entrepreneurial friend.

For all these reasons and more, as a price control, economists still tend to believe that minimum wages are inefficient and reduce the overall output and public welfare.

Minimum Wage Federalism

As of the start of 2022, 30 states had higher minimum wage rates than the federal minimum of $7.25, and a host of cities and localities have much higher statutory wage floors still. New York City had a $15 per hour minimum wage for businesses with 11 or more employees, while Seattle had a $17.27 per hour minimum wage for employers with more than 500 employees globally.

The underlying economic considerations over these state and local minimum wages are the same as those at the federal level. But one insight gleaned from studies of minimum wage increases in Seattle is that the level at which the minimum wage is set relative to local economic conditions matters.

A University of Washington study found that a minimum wage increase from $9.47 per hour to $11 per hour in 2015 resulted in no significant change in labor market outcomes, whereas the subsequent increase to $13 in 2016 reduced overall hours worked by 6.9 percent, with employers cutting back on hiring inexperienced low-wage employees relative to a control region. When the minimum wage bites harder compared to other local wages, the effects on employment are more negative.

Another insight from those same studies is that local minimum wage hikes can have very different job impacts depending on the industries and sets of employees examined. The University of Washington study found no negative employment effects of the hike to $13 per hour for the restaurant sector, for example. But it found large negative effects when focusing on low-wage employment more generally.

Given the different industrial compositions of states and their very different labor markets, the effects of a huge increase in the federal minimum wage would therefore be much riskier in poorer places or those with a high share of entry-level workers. A $15 federal minimum wage would likely have a much more damaging impact on job prospects in, say, Mississippi, where a $15 wage rate is 95 percent of median hourly wages, than New York, where it is 63 percent.

Even if you think the tradeoffs of having a relatively high wage floor are worth it, economic insights would suggest setting them at the local level, given this huge divergence across the country in productivity levels. Indeed, the whole concept of a federal minimum wage makes little sense if the argument is that policymakers are trying to set a minimum wage rate to correct for highly localized instances of monopsony power.

The negative impacts of a uniform *federal* minimum wage increase can be especially large when the labor market is weak or located in places where market wage levels are lower. Jeff Clemens's research with Michael Wither examining the impact of the federal minimum wage hike during the Great Recession found that where the state minimum wage was not already higher than the new federal level, there were significantly higher job losses.

It's important to remember that although local minimum wage setting is better institutionally than a high, blanket federal minimum wage, there are still workers who would be harmed by state and local wage floors. It is preferable to eliminate all wage floors and to have a free market in setting wages to avoid such consequences.

Conclusion

The U.S. economy provides a wide variety of jobs at many different wage rates. To get better-paying jobs, workers need entry-level opportunities that allow them to build skills and establish work histories. And if a job is too demanding for the wage offered, a worker is free not to accept it or to quit. Politicians shouldn't interfere in those workers' and employers' freely determined, private agreements. Given that wage floors eliminate many individual opportunities for mutually beneficial trades, the minimum wage shouldn't be raised—it should be repealed.

Suggested Readings

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