

# THE PROBLEM WITH THE MINIMUM WAGE



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## **Abstract:**

*With ardent supporters such as Senator Bernie Sanders, the minimum wage law is very popular amongst the populace. They believe it raises actual wages paid, cures poverty, and it thus socially just. The present paper sticks a pin in this balloon, and makes the case that this law is an unjust violation of rights, creates unemployment and poverty.*

**Keywords:** Economic illiteracy; unemployment; wages

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## INTRODUCTION

For the past decade, the United States of America has found itself in an ideological and political standoff over a point of contention that applies to several million Americans: the federal minimum wage. In an effort to appease the masses, many politicians have vocalized their concern for low wage workers and have made promises to help them out. One seemingly simple solution to assuage the perceived burden faced by these low wage and impoverished workers is to raise the federal minimum wage from \$7.25 to fifteen dollars per hour, over double its current

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value. However, this seemingly simple and effective answer to the problem has many difficulties, and it is important that they be addressed and made known to a wider audience.

The Biden Administration has spoken out in support of raising the minimum wage to this level which has only added fuel to this potentially dangerous and destructive fire. On April 27th, 2021, the Biden-Harris administration issued an executive order in this regard. It made promises such as “enhancing worker productivity”, “generating higher-quality work by boosting workers’ health, morale, and effort”, and “reducing poverty”, all of which are measures that several states across America have subscribed to as well<sup>3</sup>.

Other claims in support of this measure have been made by numerous news outlets and online discussion boards. In an article published by [oxfamamerica.org](https://oxfamamerica.org), Mary Babic makes several claims in support of the higher minimum wage. These include (Babic 2021), “It would reduce poverty, it would fuel economic growth, and it would save taxpayer money and reduce the use of government programs”. As a result of these claims, several states, such as New Jersey, have passed legislation to gradually raise the minimum wage to fifteen dollars over the course of roughly five years, and many of them cite similar reasons.

In a statement released on January 1<sup>st</sup>, 2021, Governor Phil Murphy (2021) of New Jersey told the press, “New Jerseyans working full-time deserve fair, livable wages. With our second statewide minimum wage increase, we are following through on

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<sup>3</sup> This statement from the Biden-Harris Administration gives a good idea as to what the administration plans for their inevitable federal minimum wage raise. It includes several other measures, including measures to ensure those with disabilities earn fifteen dollars an hour and to index the minimum wage to an inflation measure to keep up with the costs of living, which are all costly measures. See link for a full outline of the measures taken in Executive Order 14026. (URL: <https://www.whitehouse.gov/briefing-room/statements-releases/2021/04/27/fact-sheet-biden-harris-administration-issues-an-executive-order-to-raise-the-minimum-wage-to-15-for-federal-contractors>)

our commitment to give more workers the opportunity to join the middle class, which will strengthen our economy over the long-term”.

What these politicians and many others fail to realize is that raising the minimum wage, merely places supposed beneficiaries in a less than ideal situation: unemployment and poverty, the latter of which this proposal proudly advertises will be drastically reduced with its implementation.

In addition, there are multiple other social costs that raising the minimum wage will have, and these problems go completely unaddressed by those in support of legislation raising the minimum wage. The consequences that will be brought about because of raising the minimum wage all make the push to raise it a baffling and downright foolish effort. Each of the purported benefits of such an unnecessarily high minimum wage can be discredited and disproven with basic economic thought and principles, and the fact that despite this it has still retained so much momentum is a frightening reality. With the push to raise the federal minimum wage to fifteen dollars now seemingly more and more likely each day, it is important that the multitude of problems that arise when the minimum wage is increased are discussed and made known to the general population. Should the minimum wage be increased to this level, Americans should prepare to face several drawbacks. In effect, the minimum wage hike can best be described by the German word, *verschlimmbesserung*, which is defined as, “an attempted improvement that only makes things worse”.

#### **HARMFUL EFFECTS OF A HIGH MINIMUM WAGE**

The first consequence of raising the federal minimum wage manifests itself through the hiring practices of the companies now subjected to this new law. When it is raised to such a high numeric value, the small business and companies forced to abide by it begin to adopt more selective hiring practices. Who do these

impact? Those who have a production value that is less than fifteen dollars per hour, which is an all too significant percentage of the population<sup>4</sup>.

The best way to demonstrate this is through an example. If an individual who works for a company that manufactures a specific brand of sneaker has a production value that is estimated at twelve dollars an hour, and the minimum wage is eight dollars an hour, his production value is greater than the cost to employ him, so the company will tend to keep that employee on its payroll. At least, it will have no overwhelming motive not to do so. If, however, the minimum wage in the jurisdiction in which the employee is employed were raised to a value higher than his production value, say fifteen dollars per hour, the employee would need to increase his productivity to keep up with the raise in wages. In the likely event that the worker is unable to do so, it would be costly for the company to keep him employed, because he would no longer be a profitable worker. His employer would lose three dollars per hour as long as he were kept on as an employee. He would then be laid off and left without a job. This man, who was previously a stellar employee, is now unemployed, because of the raise in mandated wages<sup>5</sup>.

If the country were to raise the federal minimum wage, there would be a significant impact on the employment of many

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<sup>4</sup> What percentage? It is too early to tell. It will be, roughly, the percentage of the population that is unemployed. In like manner we can ask, what is the percentage of the population with a productivity level below \$7.25? We can respond, apart from those who have left the labor force since they are presently unemployable, the so-called "discouraged worker," that this is approximately, the number of people who are now jobless, divided by the labor force.

<sup>5</sup> See on this the following: Batemarco, et.al. 2014; Becker, 1995; Block, 2001; Burkhauser, Couch, Wittenburg, 1996; Cappelli and Block, 2012; Deere, Murphy and Welch, 1995; Friedman, undated; Gallaway and Adie, 1995; Galles, 2014; Gitis, 2014; Hanke, 2014A, 2014B; Hazlitt, 1946; Hovenga, 2013; Howland, 2013; Klein and Dompe, 2007; Lingenfelter, et. Al., 2017; McCormick and Block, 2000; Mincer, 1976; Neumark, 2015; Neumark and Wascher, 1992, 1995; North, 2014; Powell, 2013; Reisman, 2014; Rothbard, 1988; Rustici, 1985; Sowell, 1995; Williams, 1982

different groups of people<sup>6</sup>. A notable example are youngsters. Why are they vulnerable in particular? This is because their age and inexperience in the workforce renders their productivity, that is, the value of their labor, lower than that of other age demographics. They are the newest members of the workforce and need to gain experience in order to compete in the job market later in life. To gain this experience, teenagers turn to low wage jobs that can provide employment and on-the-job training. However, a higher minimum wage would hurt a teen's chances of being hired by the business, because it is difficult to find a teenager who has a production value greater than fifteen dollars when he has never worked a day in his life. Neumark and Nizalova state:

*"There is evidence from CPS data that minimum wages reduce formal training for 20-24-year-olds, with the evidence implying that a representative higher minimum reduces the incidence of training by about 1.0 percentage points, or about 10 percent" (449, 2007).*

Since he is now unable to acquire the skills that are demanded of a working man, due to his lack of sufficient on-the-job training and increased likelihood of unemployment, he will be at a severe disadvantage when he seeks employment somewhere that pays an annual salary. Raising the minimum wage will deprive younger generations of the ability to gain the experience needed for their future endeavors, and because of this they will struggle when they seek employment where this experience is required of them.

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<sup>6</sup> There is substantial evidence to support the minimum wage having a negative effect on black people and other minority groups. Please see Jacob G. Hornberger's article for The Future of Freedom Foundation (URL: [The Minimum Wage: Enemy of Blacks - The Future of Freedom Foundation \(fff.org\)](http://www.fff.org)) and "The Effect of The Minimum Wage on Employment and Unemployment" by Charles Brown, Curtis Gilroy and Andrew Kohen, published June 1982 in the Journal of Economic Literature, Vol. 20, No. 2, p. 487-528 for more on this topic. (URL: <https://www.jstor.org/stable/2724487>)

This reality can be justified with the simplest economic concept at our disposal: the supply and demand curve. By raising the price on labor to fifteen dollars an hour, the demand for labor, or the motivation of a business to hire, will decrease, which in turn will see the divergence between the demand and supply of labor, also known as unemployment, increase. Therefore, the concept of raising the minimum wage is ineffective and destructive. It discriminates against younger age groups trying to gain work experience by in effect forcing businesses to make use of more stringent and selective hiring practices. This prevents the inexperienced worker from obtaining the necessary skills and foundation to be able to support himself.

Those who advocate raising the minimum wage claim that by raising its level, poverty will be reduced, the economy will grow, and it will ultimately save taxpayer dollars by reducing people's dependency on government programs. These claims are all false. By raising the minimum wage, increased unemployment ensues, which means that more and more people will not have a source of income. This means they will become impoverished. That is, this occurs unless they turn to illegal means of income, which also increases as more and more people are laid off from their jobs<sup>7</sup>. Therefore, the notion that raising the minimum wage will reduce poverty is false, and those that are not poor because of legislation to raise said wage have likely turned to criminal activity to make ends meet, which is not an ideal situation for the country by any means, or live off government welfare, which keeps taxes higher than otherwise would be the case<sup>8</sup>.

Those who do not turn to a life crime will use checks from the government as their source of income, which segues into the next falsehood touted by activists: the reduction of the taxpayer

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<sup>7</sup> "Idle hands are the Devil's workshop."

<sup>8</sup> For evidence that the minimum wage creates crime, especially among the young, see Agan and Makowsky, 2020; Anderson, 2014; Beauchamp and Chan, 2014; Fone, 2020; Hashimoto, 1987; Lehman, 2021

burden<sup>9</sup>. If more and more people become unemployed, many will turn to government assistance to stay afloat. With more people requiring government assistance, the money will need to come from somewhere, and who better suited to meet the rising demand than the taxpayer? Should the minimum wage be raised to fifteen dollars, the already substantial welfare state will become even more sizeable, meaning the average American taxpayer would see his yearly income reduced even more. Those who lose their jobs and become poverty stricken because of raising the minimum wage will turn to the government for help, which will require taxes to be raised on Americans to keep up with the demand for government aid.

Another falsehood that has gained far more credibility than it should is the idea that a fifteen dollar minimum wage will somehow be a good thing for the economy. The argument states that raising the minimum wage will fuel economic growth through an increase in purchasing power. If more people are unemployed and making less money, how can that increase purchasing power? How can such a situation possibly make positive contributions to the economy?

The central arguments made in support of raising the minimum wage are dispelled easily by simple logic and reasoning. When more people are unemployed, they are not making as much money. This means that poverty will increase. Crime will also rise, since more people will turn to illegal means of earning. Taxes will grow because law abiding citizens will turn to welfare, and the economy will suffer. None of the purported benefits of raising the minimum wage hold true.

A common retort by many minimum wage supporters is that businesses should simply raise their prices so they can support their employees with the new wage. While this again seems like an easy solution, it only places the weight of the negative effects of

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<sup>9</sup> There is the possibility that some will live off a fixed income provided by parents or other family members, but there will still be a substantial increase in taxes.

this wage on someone else. Hazlitt (1946, p. 135) put paid to this notion:

*“A higher price for the product may not be possible: it may merely drive consumers to the equivalent imported products or to some substitute. Or... the higher price will cause them to buy less of it. While some workers in the industry may be benefitted from the higher wage, therefore, others will be thrown out of employment altogether”.*

By raising the prices of a good, the consumer will seek alternatives, which may include simply not purchasing the good at all, putting the producer out of business<sup>10</sup>. It is not an effective means of offsetting the effect of a higher minimum wage. There is also the “coulda, woulda” phenomenon. If the seller could have made more profits by raising prices, there would have been a tendency for him to have already done so. He did not need a rise in the minimum wage to entice him to do so. The fact that he did not indicates there was less profit in doing so.

#### OTHER “UNSEEN” COSTS

A raise in the minimum wage could also have several negative costs that would go unseen by many. These impact the dynamic of the employer-employee relationship, lead companies to misallocate skilled over unskilled labor, as well as see companies start to find loopholes in the law and begin to exploit labor at an unprecedented level.

The impact on the employer-employee dynamic is a potential social setback the raise of the minimum wage would bring about. Carden (2009) summarizes,

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<sup>10</sup> An exception to this would be if the item is inelastic, in which the demand for the item is less affected by changes in price. Examples include gasoline, cigarettes, and salt.

*“A job can be done by either three unskilled workers or two skilled workers. If the unskilled wage is \$5 per hour and the skilled wage is \$8 per hour, the firm will use unskilled labor and produce the output at a cost of \$15... we impose a minimum wage to \$6 per hour, the firm will instead use two skilled workers and produce for \$16 as opposed to the \$18 cost of using unskilled workers... we see an increase in average wages to eight dollars per hour in spite of the fact that the least skilled workers are now unemployed”.*

This again negatively affects young people who are looking for a job to acquire the necessary skills to be able to become productive members of the work force. Because employers will prefer the skilled laborers who ultimately end up costing less to employ, with the advent of the increased minimum wage, the inexperienced who are in dire need of experience are disadvantaged.

Additionally, there arises an issue between the employer and the employee. The higher minimum wage causes the cooperative and mutually beneficial nature of employment contracts to be eliminated and places the employer and the employee at odds with one another. Carden (2009) writes, “Encouraging the view that employment is a raw deal has created needless acrimony. At the margin, this intimidates people and discourages some from becoming employers themselves”. When the dynamic between the worker and his boss is tarnished, it hurts production.

Perhaps the most glaring unseen cost of raising the minimum wage is that companies will turn to illegal means to offset the losses in revenue from the higher minimum wage. This in turn would see the businesses that followed the law fail, but those who exploit it succeed, which is a strange but possible reality; a world where those who follow the law end up suffering the most. For these businesses, they have no other options, and it becomes a high-risk-reward situation, because if they were to not take the risk of bending the law, they would certainly go under. Carden (2009) writes, “Those with a comparative advantage in evading

(or violating) the law will be most successful... restriction and regulation reduces the relative price of dishonesty, which means we can expect greater levels of it in the marketplace". To raise the minimum wage puts businesses in a scenario where they have greater incentives to break the law to survive. This damages the perception, efficiency and reputation of American businesses.

If this law is such as disaster, particularly for the "least, the lost and the last" amongst us, that is those who are unskilled, typically young and from impoverished demographics, why oh why is it still on the books? Why is it so popular? Why, instead of a popular and public discussion about ending this enactment, are we contemplating raising its level, and thus making it even more harmful to those who can least afford its deprivations?

Two hypotheses come to mind as explanations for this strange phenomenon. One is just plain, old economic ignorance, economic illiteracy. According to that old aphorism, "No one ever went broke underestimating the intelligence of the American populace"<sup>11</sup>. According to this hypothesis, this applies in spades to an understanding of the dismal science. To make matters even worse, not only is the general public sadly mistaken about the effects of this law, they are highly opinionated about it.

Here is Rothbard (1995) on this matter:

*"It is no crime to be ignorant of economics, which is, after all, a specialized discipline and one that most people consider to be a 'dismal science.' But it is totally irresponsible to have a loud and vociferous opinion on economic subjects while remaining in this state of ignorance".*

This is a serious explication. It does not tell the entire tale, but it is part of any elucidation of this curious phenomenon.

But there is a more insidious explanation too. In order to see this, we ask the classical economic question: cui bono? Who

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<sup>11</sup> H.L. Mencken. <https://www.facebook.com/mises.institute/photos/a.123255378934/10153172836158935/?type=3>

benefits from the minimum wage law? Well, let's see. Its main effects are to unemployed unskilled minority youth. Who can possibly gain from any such occurrence? One possibility is prison guards. If these young men cannot find a job, they will get bored. They will turn to illegal activities. The police are stronger, better financed, more organized, than they are. The prison population will be enhanced, when they are caught and punished, calling forth more employment for jail guards, and higher salaries for them. This is a good hypothesis; the only trouble with it is that there is not a shred of evidence in its behalf.

Another candidate in our *cui bono* sweepstakes are labor unions. Whenever these organizations seek a rise in pay, the first thought of their employer is to higher cheaper substitutes<sup>12</sup>. These organizations are always and ever in competition with less skilled workers. Two or three or four of the latter, properly supervised, can often do the job of one of their members. When the firm attempts to substitute the former labor input for the latter, organized labor is not a happy camper. They denigrate these replacement workers as "scabs"<sup>13</sup> and to repel them by use of physical force. There are several problems with this. One is the optics of the enterprise. Middle aged white folk trying to beat up young black males. The other is that the latter fight back. Far better would be a policy which disincentivizes the corporation from hiring these "scabs" in the first place. It is far better to price them out of the marketplace. A gold star for anyone who can figure out what public policy can attain that goal.

Lastly, consider the ethics of this legislative enactment. The authors of the present paper now make an offer to you, gentle reader. We will pay you \$3 per hour to come and wash our car. We will of course not force you to do any such thing. If you agree, it would be entirely up to you. According to the minimum wage law,

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<sup>12</sup> Rowboats can be made of wood or plastic. If the price of one of them rises, relative to the other, the manufacturers will move in the direction of the now cheaper input.

<sup>13</sup> This seems pretty "hateful" in our otherwise sensitive epoch.

if we were serious about this offer<sup>14</sup> we could be placed in prison. Strictly speaking, you could too, if you took us up on it; however, probably you would be set free since you would be considered a victim. But not us. We would be seen as exploiters. But all we did is put another offer on the table for your consideration. We enhanced your set of choices. We violated no rights. And, yet, it would be off to the hoosegow for the likes of us. This is ethical?

### CONCLUSION

To raise the minimum wage would be a foolhardy undertaking. If it were to be raised, it would set off a chain of negative events that would hurt many people. It would render businesses unable to afford keeping workers who do not produce as much as they are legally required to be paid, which would create more unemployment, and many young workers would then be deprived of the on-the-job training that is necessary to become a contributing member of society. This would increase poverty and crime, as well as taxes on those who have jobs, as they would bear the burden of the increasing number of people qualifying for government assistance. There exist other negative costs that go unnoticed, as well. These include the preference of skilled over unskilled labor, further alienating new unskilled workers, putting the employer and employee at increased odds with one another, and with this tense environment the business will suffer, as harmony is key in a successful place of business. Then there is the reality that more and more companies will turn to illegal solutions to their woes, putting the law-abiding businesses at a paradoxically disadvantage. Keeping the minimum wage where it is now is better than raising it. Best of all would be to eliminate this pernicious law entirely.

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<sup>14</sup> We are not. We do not want to go to jail.

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