THE FAILURE OF THE MINIMUM WAGE LAW

By James F. Ragan, Jr.

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Preface

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The underlying research was performed at Washington University. Dr. Ragan is now Assistant Professor of Economics at Kansas State University.

Murray L. Weidenbaum, Director
Center for the Study of American Business
Washington University
St. Louis, Missouri
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There is universal concern over the employment problems facing youths. That is not at issue. What is at issue is how to solve these problems. Among other things, we need to determine whether specific programs enhance youth employment prospects or detract from them. This paper focuses attention on one such program: minimum wage legislation.

The severity of youth labor market problems can be measured in a number of ways. One common measure is the unemployment rate of 16-19 year olds. This rate has drifted upward over the years and now stands at a lofty 17½ percent. The unemployment rate of nonwhite teenagers is a staggering 40 percent. Yet even these numbers understate the severity of the situation. Not counted among the ranks of the unemployed are those youths who, unable to find jobs, have become discouraged and dropped out of the labor force.

The problem is not so much one of being unable to find high-paying jobs, but of having difficulty finding any job, high-paying or otherwise. The data indicate that youths tend to be quite realistic in their wage expectations. Aware of their limited qualifications, they are not holding out for high wages. Indeed, many youths express a complete willingness to work for less than the minimum wage. But, given their limited skills and experience, they are priced out of the market by the minimum wage.

Therefore, in my opinion, minimum wage legislation is a major factor contributing to youths' employment difficulties. To be sure,
other factors are also at work. So eliminating the minimum wage or reducing it would not completely solve the labor market problems facing youths, but this would be a big step. And even a moderate expansion in youth employment and reduction in youth unemployment would be welcome in today's labor market.

One of the most basic propositions of economics is that demand is inversely related to price. This proposition holds for the labor market as well as for product markets. An increase in the minimum wage, by increasing the price of low-productivity labor, reduces the demand for that labor. As a consequence, the number of youths and other low-productivity workers employed declines. This has been confirmed by recent econometric studies—studies by Drs. Mincer, Gramlich, and Welch, and others, including myself. For example, I found that the 1966 minimum wage amendment forced about 1/4 million 16-19 year olds out of work. Other interesting findings—in addition to the adverse effect of the minimum wage on youth employment—are that the minimum wage increases youth unemployment rates, forces some youths out of full-time jobs and into part-time jobs, and makes youth employment more vulnerable to the cyclical state of the economy. Furthermore, the loss in jobs attributable to the minimum wage is greater for nonwhite youths than for white youths.

If the minimum wage has such adverse effects, then why has it received the support of numerous leaders throughout the United States? In my opinion, most of those supporting the minimum wage do so with good intentions. They may be cognizant of the adverse effects of a minimum wage. Indeed, some supporters of the minimum wage, such as
Secretary of Labor, Ray Marshall, acknowledge that an increase in the minimum wage will reduce youth employment. But, at the same time, they share a concern about poverty and, to their credit, want to eliminate it. A common statement in defense of raising the minimum wage is that the current minimum is just not high enough to guarantee a sufficient standard of living. The current minimum, it is asserted, leaves workers below the poverty line. Unfortunately, raising the minimum wage will not solve the problem.

Poverty is directly related to income, not wage rates. It is hard to see how a person unemployed at a minimum wage of $2.65/hour is better off, less impoverished, than a person employed at a wage of $2/hour. Those losing jobs as the result of a minimum wage experience a reduction in income, not an increase. Even those remaining employed, in spite of the minimum wage, may suffer a loss in income. Edward Gramlich, in a study recently published by the Brookings Institution, found evidence that minimum wage legislation reduced the average work week of youths, shifting some youths out of full-time jobs and into part-time jobs. And, of course, if hours of work decline, then, even at a higher wage, income may fall. For these two reasons—a reduction in employment and a reduction in hours worked—the minimum wage is not an effective or efficient way to deal with poverty.

Another point is worth making about the relationship between the minimum wage and poverty. The wage rate commonly cited as necessary to raise a worker above the poverty line, currently about $2.95 an hour, is actually the wage necessary, assuming a forty-hour work week, to put a family of four above the poverty line. Yet, most youths are not
household heads, but secondary or supplemental workers. Conversely, the vast majority of household heads already earn more than the minimum wage. So where is the logic in requiring a youth, or for that matter anyone else, to refuse work unless he can make enough to support a family of four? And how can we tell a single person, who if he works 40 hours a week needs a wage of only about $1.35 an hour to reach the poverty line, that he cannot work unless he receives a wage much higher than that? Should we really require that he be able to earn enough, by himself, to support a family? And, to repeat an earlier point, the minimum wage, by taking jobs away from some secondary workers, prevents them from contributing to family income. Since most families rely on more than one wage earner, this is an important consideration. Removing a source of income, however modest, will increase the burden on other members of the household. We can only conclude that the argument that a minimum wage is necessary to alleviate poverty has little merit.

The basic problem is that while the Fair Labor Standards Act can legislate what employers must pay if they are to hire workers, it cannot legislate worker productivity. Therefore, workers who cannot produce enough output to be worth the minimum wage are denied jobs. Employers, prevented from hiring workers at less than the minimum wage, are denied profits. The government, unable to tax these nonexistent profits, finds its revenue reduced; and, if it must now support the workers whose jobs it has effectively taken away, its net revenues will be further reduced. Society will also be denied the fruits of the lost production. Furthermore, some students, unable to find jobs as a
result of the minimum wage, may find they are unable to support their education and will be forced to drop out of school.

The costs of the minimum wage do not stop here, however. The effects of a minimum wage are compounded over time, especially for youths. Many youths are not hired at the minimum wage because they lack the skills, experience, and work discipline to make their labor worth the minimum wage. But, by being denied the chance to work at low wages, they are prevented from acquiring the skills, experience, and other characteristics which would increase their value to employers. So we have a vicious circle. Because of the minimum wage, employers do not hire low-productivity youths; and, because they are not hired, youths have less of a chance to develop those very attributes associated with high productivity. The minimum wage therefore not only makes it more difficult for a youth to obtain a job today, it makes it more difficult for him to find a job in the future. And it is during a person's younger years that he should be sampling the labor market, learning about the world of work, finding out what type of work he wants to pursue, picking up the skills and experience necessary for that line of work, and in general developing a sense of work responsibility.

For such reasons, I favor a lower minimum wage. I certainly find it inadvisable to raise the minimum wage another 15 percent on January 1, which is what Congress is apparently getting ready to do. That would only aggravate the already severe employment problems faced by youths and other low-productivity workers. It appears, nonetheless, that the current minimum is about to be raised. If so, implementing some type of split or differential minimum wage may prove advantageous. One such
differential has been hotly debated by Congress as well as by businessmen, union leaders, and others interested in shaping a new minimum wage policy. In particular, because youths are the group most adversely affected by the minimum wage, some argue that there should be a youth differential. That is, the minimum wage for youths should be set below the adult minimum wage—perhaps equal to 75–85 percent of the adult minimum.

A youth differential, by lowering the average price of labor, would increase aggregate demand for labor and therefore aggregate employment. Yet, while total employment would increase, along with youth employment, a youth differential could be expected to reduce adult employment. The magnitude of decline would depend on the ease of substituting youths for adults as well as on differences in productivity between youths and adults.

Employers are unlikely to respond to a youth differential by replacing mature and experienced adult workers with youths. Indeed, in many instances, youths do not compete with experienced adults. There may, however, be some substitution of inexperienced youths for inexperienced adults—perhaps housewives without special skills who are entering the labor force or reentering after a prolonged absence. In that case, some adults could be displaced by youths. In my view, this is not so much a problem of a differential minimum wage, but of a minimum wage per se. But, to continue, a differential can be expected to result in some job loss for adults.

How much displacement occurs will depend on the extent to which youths and adults are substitutable in the labor market, i.e., on the
extent to which they do the same type of work. Some researchers, including Jack Carlson and Drs. Goldfarb and Yezer, suggest there is only very limited substitutibility of youths for adults. In that case, the youth employment gain brought about by a youth differential would be accompanied by only a very modest reduction in adult employment. That is, the increase in youth employment would for the most part translate into an increase in total employment rather than a decrease in adult employment. More research is needed, however, before we can speak with any confidence about the substitutibility of youths for adults.

Even if it turns out that few adults would lose their jobs as a consequence of a differential minimum wage, a question remains: How large a job loss for adults are we willing to tolerate? Is a youth differential socially desirable if 3 new youths find jobs for every 1 adult displaced by the lower youth minimum wage? What if 2 adults lose their jobs for every 3 youths gaining employment? Is that a socially acceptable tradeoff? Ultimately, what we are asked to decide when considering the youth differential is the value to society of an employed youth vis-a-vis an employed adult.

Actually, we need not accept any increase in adult joblessness in order to expand youth employment. The most simple solution to expand both youth and adult employment would be to uniformly reduce the minimum wage. But, given the political realities of the day, an alternative solution can be found. Since the problem with a youth differential is that some low-productivity youths will displace low-productivity adults, why not extend the lower minimum wage to low-productivity adults as well as to youths? What I have in mind is
allowing a lower minimum wage for all workers, adults as well as youths, during their "break-in" period, perhaps their first 6 months with an employer. If allowed to pay lower wages initially, companies would hire workers they would not otherwise employ, vis., workers whose labor is worth less than the full minimum wage. During their first 6 months on the job, workers would gain experience and pick up job-related skills valuable to the company. Given the company's investment in the worker and the consequent increase in the worker's productivity, the company would have a strong incentive to retain the worker, even after the break-in period expires and it is required to pay the full minimum wage. The lower minimum wage, even if only temporary, enables a low-productivity individual to acquire valuable skills, experience, and work discipline and therefore helps the individual break out of the vicious circle referred to earlier. That is, the lower minimum wage helps the individual obtain those skills and attributes required in workers if they are to be hired at the full minimum wage. Moreover, given employers' desire to minimize costs, they have no incentive to replace experienced workers with inexperienced workers. Any wage costs saved by hiring an inexperienced worker at the lower minimum wage would be fully offset by the hiring and training costs associated with the new employee. Therefore, there should be no displacement of experienced workers by the inexperienced, only an increase in total employment. The differential I am proposing then is a low-skill differential, rather than an age differential.

As emphasized throughout this paper, a basic flaw in minimum wage legislation is that it makes low-productivity labor more expensive and therefore prevents some low-productivity workers from gaining jobs or experience. The temporary low-skill differential I propose alleviates
this problem. Another program which has merit is the wage subsidy, a
program in which the government pays some portion of the wages of low-
productivity workers. Under the wage subsidy program, an employee
may be receiving $2.65 an hour, for example, while the company is
paying perhaps only $2.00 an hour; the government pays the difference.
Since a private employee pays only a portion of the wage bill for
low-productivity workers, the employer has an incentive to hire additional
workers. That is, the wage subsidy, by lowering the price of labor,
induces employers to expand employment. This is in contrast to the
minimum wage program which, by making labor more expensive to employers,
induces them to cut back employment. This is also in contrast to
federal jobs programs, which expand the public sector rather than the
private sector.

To summarize, the minimum wage does not accomplish the job it was
apparently designed for. It does not provide a floor on income. The
goal of income maintenance can be better pursued through other programs.
What the minimum wage does bring about is a reduction in the employment
of youths and other low-productivity workers, thereby denying these
workers the chance to obtain the skills and experience necessary to
increase their productivity.

The economy could be operated more efficiently if the minimum wage
law were repealed, replaced perhaps by a program which recognizes that
to earn income, a job is needed, as well as a wage rate. One such
program worthy of consideration is the wage subsidy program, which
provides employers with an incentive to expand rather than contract
employment. If the minimum wage is to remain a fixture in this country,
I would like to see one amendment implemented. In particular, I would like to see a lower minimum established, at least on a temporary basis, for low-productivity workers. This would increase employment of such workers and give them the chance to acquire the skills and experience necessary for a high wage. It would therefore make it easier for such workers to find jobs and retain them, even after companies are required to pay the full minimum wage.