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The Negative Effects of the Minimum Wage

Brief Analysis

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My Social Security

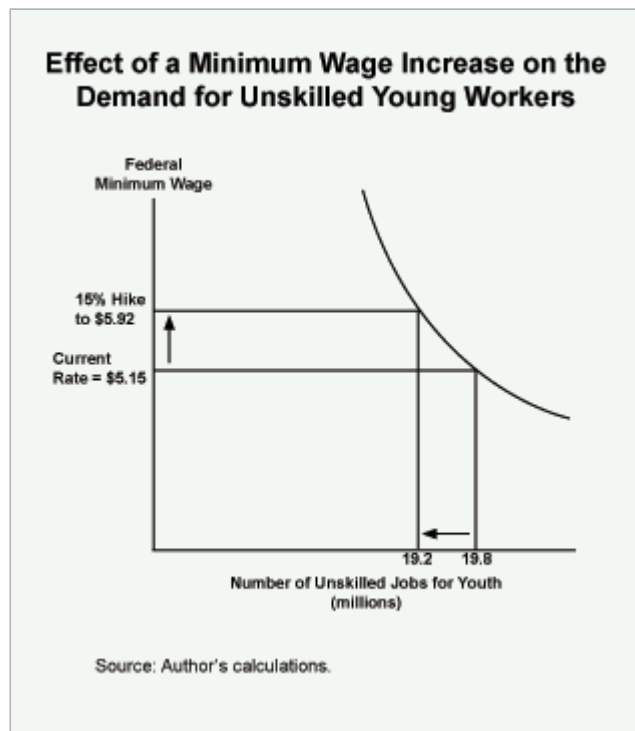
Women in the Economy

Various state legislators and interest groups around the United States are pushing for increases in the minimum wage. In California, for example, even Republican Gov. Arnold Schwarzenegger now advocates raising the state minimum wage from its current \$6.75 an hour to \$7.75 by July 2007. But when the minimum wage law confronts the law of demand, the law of demand wins every time. And the real losers are the most marginal workers — the ones who will be out of a job. [See the figure.]

Creates Unemployment.

In a free labor market, wage rates reflect the willingness of workers to work (supply) and the willingness of employers to hire them (demand). Worker productivity is the main determinant of what employers are willing to pay. Most working people are not directly affected by the minimum wage because their productivity and, hence, their pay, is already well above it.

The law of demand says that at a higher price, less is demanded, and it applies to grapefruit, cars, movie tickets and, yes, labor. Because a legislated increase in the price of labor does not increase workers' productivity, some workers will lose their jobs. Which ones? Those who are the least productive.



Minimum wage laws mostly harm teenagers and young adults because they typically have little work experience and take jobs that require fewer skills. That's why economists looking for the effect of the minimum wage on employment don't look at data on educated 45-year-old men; rather, they focus on teenagers and young adults, especially black teenagers. Paul Samuelson, the first American winner of the Nobel Prize in economics, put it succinctly back in 1970. Analyzing a proposal to raise the minimum wage to \$2 an hour in his famous textbook, *Economics*, he wrote, "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?"

A comprehensive survey of minimum wage studies found that a 10 percent increase in

the minimum wage reduces employment of young workers by 1 percent to 2 percent. To put that into perspective:

- Gov. Schwarzenegger's proposed 15 percent increase in the state minimum wage would destroy about 35,000 to 70,000 unskilled jobs — putting 1.5 to 3 percent of young Californians out of work.
- Overall, the proposed minimum wage increase in California would eliminate about 70,000 to 140,000 jobs.
- A 15 percent increase in the minimum wage nationwide would destroy about 290,000 to 590,000 young people's jobs, and about 400,000 to 800,000 jobs overall.

Fortunately, and to his credit, Gov. Schwarzenegger wants to avoid indexing the minimum wage to either the consumer price index or a wage index, as the French government did in 1970. Indexing the minimum wage makes it much harder to get the inflation-adjusted minimum wage down and makes it permanently harder for the least-skilled workers to find jobs. The rising minimum wage in France since then has added to the country's youth-unemployment woes.

Encourages Teenagers to Drop Out. Some minimum wage advocates argue that teenagers should be in high school or college anyway — not working — and therefore the loss of jobs for young workers is somehow not very harmful. Ironically, though, economic studies have shown that a higher minimum wage entices some teenage students to drop out. With fewer jobs to go around and a greater number of dropouts, some newer dropouts take jobs from the less-educated and lower-productivity teens who had already left school.

Even worse, the failure to find work early in their lives harms young people later in their work lives. For example, economists David Neumark of the Public Policy Institute of California and Olena Nizalova of Michigan State University found that even people in their late 20s worked less and earned less the longer they were exposed to a high minimum wage, presumably because the minimum wage destroyed job opportunities early in their work life.

Hurts the Poor. Proponents of a higher minimum wage often argue that that it's difficult to support a family when the only breadwinner earns the current minimum wage. This claim is flawed, for three reasons.

First, for a minimum-wage increase to help a single breadwinner earn money for his or her family, the worker must have a job and keep it at this higher wage. A job at \$5.15 an hour, the current federal minimum, is much better than no job at \$6.00 an hour.

Second, increases in the minimum wage actually redistribute income among poor families by giving some higher wages and putting others out of work. A 1997 National Bureau of Economic Research study estimated that the federal minimum-wage hike of 1996 and 1997 actually increased the number of poor families by 4.5 percent.

Third, a relatively small percentage of the workers directly affected are the sole breadwinner in a family with children. A study by the Employment Policies Institute shows that in California, for example, only 20 percent of the workers who would have been directly affected by a proposed 2004 minimum-wage increase were supporting a family on a single, minimum-wage income. The other 80 percent were teenagers or adult children living with their parents, adults living alone, or dual earners in a married couple.

Reduces Other Job Benefits. Even when minimum-wage increases don't put low-wage workers out of work, they don't necessarily help them either. The reason: Employers respond to forced higher wages by adjusting other components of employee compensation, such as health insurance or other benefits. Although few minimum wage

workers have employer-provided health insurance, employers have found other ways to adjust, such as cutting on-the-job training. In their study of changes in the minimum wage laws between 1981 and 1991, Neumark and Federal Reserve Board member and economist William Wascher concluded, "[M]inimum wages reduce training aimed at improving skills on the current job, especially formal training."

Reduces Competition. The main proponents of the minimum wage are labor union officials who use substantial resources to lobby and testify for higher minimum wages. But they have a self-interested motive: hobbling the competition. Almost all union members make well above the minimum wage, but by getting the minimum wage increased, they can reduce competition from less-skilled workers who would receive lower wages. Similarly, large employers who pay more than the minimum, Wal-Mart being the most recent example, also push for higher minimum wages, presumably to make things more difficult for their low-wage competitors.

In addition to labor unions and major corporations, some politicians also like to advocate a higher minimum wage. Politicians in the Northeast, for example, have traditionally favored high federal minimum wages to stem the flow of jobs from the North to the lower-wage South. Indeed, in 1957, Massachusetts Sen. John Kennedy argued for a higher minimum on the grounds that it would make low-wage black workers in the South less competitive with the higher-wage white workers whom he represented.

Imposes an Employer Mandate. Although economists generally focus on the negative effects of the minimum wage on vulnerable workers, there is another group that also deserves to be considered: employers. How can we justify forcing employers, the very people who are taking risks to provide jobs in the first place, to pay a higher wage? If "society" decides that unskilled people should be paid more, why single out employers rather than, say, taxpayers in general, as the people to pay them?

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