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The Minimum Wage Mandate

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The Minimum Wage Mandate

Abstract

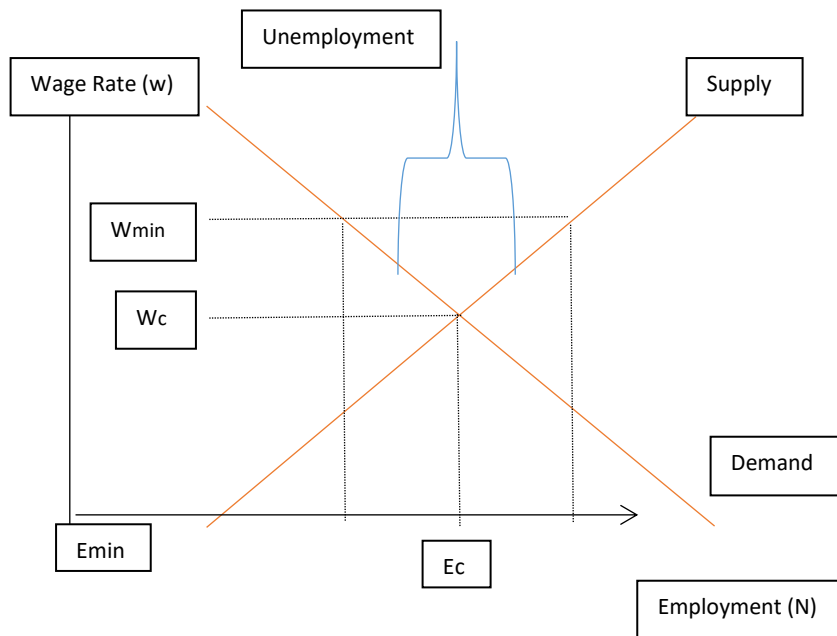
The minimum wage rate has been highly controversial and heavily debated especially in recent years and the most recent election cycle. At its core, the minimum wage has the power to increase major components of an economy, including national GDP, price levels, output, and overall standards of living. It also protects workers and employees from predatory and exploitative firms that will try and hire labor at an extremely low cost to them. According to the Economist (2013), the United States has a low minimum wage rate compared to other developed countries. However, increasing the rate would force businesses and firms to cut cost elsewhere to maintain a positive profit level. A common way for businesses to cut cost from an increase in wage rate is to cut the number of employees they hire. This is obviously problematic as the minimum wage law was designed to protect workers, not to cause an increase in unemployment. An increase in unemployment can have a number of magnifying effects on an economy such as a reduction in output, consumption, and overall GDP as well as an increase in government spending from unemployment benefits. We can analyze the effects on employment from an increase in minimum wage through a supply and demand for labor graph. Graphed above is the supply of labor from the consumer's perspective, which is how much labor the work force will provide at any given wage rate. The demand for labor is from the producer's perspective, which is how many workers any given firm will employ at a given wage rate. In a competitive market the market forces would create a competitive wage, which would equate to a full level of employment. However, a minimum wage would increase the cost to companies, reducing their desire for labor. The minimum wage increase would cause an increase supply in labor, leaving excess workers without a job and thus increasing unemployment.

The Minimum Wage Mandate

Brandon Fricke

The minimum wage mandate has been highly controversial since its inception under President Franklin Roosevelt in 1938. The original intention of a federal mandated minimum wage was to stop predatory businesses from paying employees a low wage for their work. It has also been used to make sure the heads of house receive an adequate income to support their families. Today the minimum wage mandate is at \$7.25 an hour and covers approximately 85 percent of the labor force market. While the minimum wage law had good intentions behind it, supporting workers' rights and stopping predatory firms, there were many unintended consequences to come from this law. As companies and firms were now forced to increase their employees' wages, they looked to find ways to cut cost elsewhere to keep profits high including raising prices, cutting workers, or moving to a more capital driven production, all of which were unintended negative consequences. In recent years there has been yet another call for an increase in the current minimum wage rate, which would be the twenty third time the federal government would have made such an increase since it was created. These consequences can be attributed to many of the economic theories we have discussed in class, primarily the simple supply and demand of labor as well as efficiency wages and marginal productivity of labor. By taking a close look at the labor market we can explain why an increase in the federal minimum wage rate would cause inadvertent adverse macroeconomic changes in the economy for both the short run and long run.

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As Wilson briefly explains in his Policy Analysis (2012), the excess unemployment is spread throughout many factors. First, firms can reduce the amount of hours each employee will work, and forcing some full time employees to now only work part time. Firms may also delay creating new job openings causing a further increase of unemployment. Second, workers that were previously in an uncovered sector of the economy may now come into the covered sector of the economy in hopes of getting a job with an increased minimum wage. Additionally, citizens that did not have the incentive to work before may now be motivated to join the labor force if the new minimum wage rate either matches or exceeds their reservation wage. The reservation wage denotes the minimum wage rate required to bring a person into the labor force instead of devoting 100 percent of their time to leisure. In the more recent past firms have chosen to cut hours rather than the total number of employees they keep on their payroll. There have been increase turnover cost in the labor market, and firms are trying to combat this. Turnover cost, as Borjas (2016) explains, refers to the cost a firm faces from firing and then subsequently rehiring and training a new worker for the same position.

Increasing the minimum wage rate may prove detrimental to long term growth for companies as well as employees. If the firm faces a higher wage cost, they may move to cut worker investments in the long run. Reducing worker specific training will decrease a workers lifetime age earnings profile, which only serves to be counterproductive to the theory and purpose behind a minimum wage rate increase. Additionally, minimum wage rates are often directed at helping the working poor receive a living wage; however the unintended negative consequences are also directed toward them as well. When firms make employment cuts, they often target the least marginally productive workers first. According to Bernanke and Abel (2010), many firms already opt to pay their employees the efficiency wage, which is higher than the competitive wage rate. The theory is that a worker is likely to be more productive and not risk being fired for unproductivity or bad behavior, thus increasing output for that firm, if he or she receives a wage that is higher than the competitive rate. Additionally a worker has an increased incentive to stay with their current firm, thereby reducing the turnover cost of that firm. So an increase in the minimum wage would only serve to cut those who are least productive in the work force; exactly the opposite of what was intended.

Many will argue that an increase in the minimum wage will reduce the poverty rate in the United States by giving the heads of house an income they can support a family with. However, using Wilson's (2012) findings we can easily disprove this. In his paper he stated that roughly half (49.0 percent) of all recipients of minimum wage were young adults age twenty four or lower. Furthermore, twenty five percent of minimum wage recipients above the age of twenty five voluntarily worked only part time. So taking these numbers, a majority of the recipients of minimum wage are young adults who are most likely working for a little extra cash while they finish up schooling. Once they finish schooling they would then be able to easily find a job that pays well beyond the minimum wage rate. The percentage of recipients that work only part time were voluntary, and thus could increase their hours worked if their personal consumption required it. Only a mere 17 percent of those who receive minimum wage and work full time are at or below the poverty level. So increasing the minimum wage in hopes of it reducing poverty is unreasonable. It will have an effect on the poverty line as those below it will now receive a higher income; however it is not a policy for long term poverty reduction. Most workers who receive minimum wage are either young, part time, or come from wealthy families not below the poverty line.

The federal minimum wage has had positive outcomes from it; however policy changes could further increase its usefulness. Increases in the minimum wage rate should not stem from the hopes of reducing poverty or increasing standards of living. It should be increased at a rate only to account for inflation and to hold predatory firms accountable for their workers. Furthermore incentives should be offered to those working for minimum wage to increase their education, increasing the likelihood of receiving a job above the minimum wage rate. Firms can be incentivized to increase their investments on workers which in turn would increase their age earnings profile in the long run. While the minimum wage law was effective in combating predatory firms, it can be modified to not have huge unintended consequences. Since the federal minimum wage mandate took effect under the Fair Labor Standards Act in 1938, firms have always been looking for ways to reduce cost. This often comes at the employee's expense as an unintended negative consequence from the mandate. Increased unemployment, reduced hours, and increased prices are all caused from an increase in input cost for firms. While the minimum wage was intended to help those struggling to get by it failed to account for the firm's decision making ability to maintain a positive profit level. So those who were able to keep their job did see an increase in pay, however the result from this is that many who were employed before are now left without work.

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