Free the Wage

How the minimum wage hurts employment for Hispanics and low-skilled workers

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INTRODUCTION

In recent years, the minimum wage has been a charged, polarizing, hot-button issue in American politics. It has also attracted significant attention in economic research, as advocates and opponents alike attempt to measure its effects on employment, prices, and poverty. The effect of the minimum wage on employment is especially significant, and it stands out in public polling on the subject. A majority of Americans—67 percent—support raising the minimum wage as a general principle, but this support diminishes in certain contexts.[1] When Americans are asked if they would continue to support the minimum wage even if businesses were forced to cut jobs, this 67 percent support reverses to 58 percent opposition. Support for the minimum wage among Hispanics is even more sensitive to concerns about employment than that of the general population. In fact, while 74 percent of Hispanics support the minimum wage in the abstract, 58 percent oppose it if it will lead businesses to cut jobs. Given that Hispanic attitudes toward the minimum wage are so sensitive to concerns about its effects on employment, the issue deserves serious attention in economic research.

This report builds on existing research to examine the effects of the minimum wage on Hispanic employment. To do this, it relies on a theory of wages as prices outlined by F. A. Harper in order to lay out a number of predictions regarding the relationship between the minimum wage and employment.[2] Then, using data from the Bureau of Labor Statistics, this report examines trends in the employment-to-population ratio of certain types of Hispanic workers—such as younger or less skilled workers—as they relate to changes in the minimum wage from 1974 to 2014, based on methodologies used in two previous analyses.[3] From this analysis, we conclude that Hispanic concerns regarding the results of raising the minimum wage are well founded.

THEORETICAL CONSIDERATIONS

One of the most common misconceptions that motivates support for raising the minimum wage is a view that treats wages as levers that *set* value rather than metrics that *reflect* value. Labor is a good, and—like other goods—is supplied and demanded at various prices.[4] These prices take the form of wages, where employers "buy" labor from employees. The employer values different amounts and kinds of labor according to the value they

[1] Reason-Rupe, "April 2014 National Telephone Poll," April 3, 2014, http://www.scribd.com/doc/216081750/Reason-Rupe-April-2014-National-Telephone-Poll.
[2] F. A. Harper, *Why Wages Rise* (Irvington-on-Hudson, New York: Foundation for Economic Education, 1957).
[3] Kevin Erdmann, "Teen Employment and the Minimum Wage, 60 Years of Experience," *Idiosyncratic Whisk*, January 16, 2014, http://idiosyncraticwhisk.blogspot.com/2014/01/teen-employment-and-minimum-wage-60.html.
Antony Davies, *Unintended Consequences of Raising the Minimum Wage* (Mercatus Research, Mercatus Center at George Mason University, Arlington, VA, October 2013), https://www.mercatus.org/publication/unintended-consequences-raising-minimum-wage.
[4] Ibid.

contribute to the organization. For instance, if an employee flipping burgers in the kitchen of a fast food restaurant produces $10 worth of burgers every hour, he might be paid a wage around $7.50 an hour. Because the labor exchange is voluntary, it is mutually beneficial in the sense that both parties believe they are getting a better deal compared to their alternatives. Otherwise, they would not have made the exchange voluntarily. The worker places a higher value on $7.50 for an hour of flipping burgers than on the available alternative ways to spend that time. Conversely, the employer values an hour's worth of burgers more than $7.50, because the employer is able to sell burgers to customers for more than that amount. As a result, both are willing to trade, the restaurant is able to keep operating, and the employee is able to continue earning income.

At this point, the problem with viewing wages as levers that set value (rather than metrics that reflect value) becomes clearer. No matter what the worker is paid, the value of the burgers cooked in an hour is still $10, because that's the value customers have placed on the product. If the minimum wage were raised to $15 an hour, the value to the employer of the worker's labor would remain the same, but the government-mandated price of that labor would surpass the value. In that case, the exchange between the employer and the employee is no longer mutually beneficial, and therefore will no longer take place voluntarily. A worker applying for this job at such a wage may not be hired; if the worker already has the job and the law forces an increase in wages, the worker may very well lose the job.

In order to compensate for the increase in the price of labor, workloads previously given to two employees might be forced onto just one, who will have to work even harder to keep up. The restaurant may be forced to raise prices, which may cause it to lose customers and possibly go out of business entirely. The restaurant may be forced to automate its labor and replace expensive human workers with self-checkout machines. These are all possible outcomes of artificially setting a price floor for labor.

The function of a free price—which is to say, a market price that is not distorted by the state—is to direct use of the fewest resources to meet the most needs in society, without the need for any central planner to direct individual decision-making. Given scarce resources, only enough of what society needs should be produced: no more, and no less.[5] In this report, the resource being produced is labor, and the function of free wages is to connect supply and demand for labor as efficiently as possible. By allowing prices to adjust according to changing supply and demand, free wages avoid both surpluses and shortages of labor, both of which result in underemployment. The chart below illustrates the effects of price freedom in efficiently connecting supply and demand based on the interaction of two basic rules:[6]

[5] Harper, *Why Wages Rise*. 82
[6] Ibid. 81

1) Less of a thing will be wanted at a high price than at a low price, progressively.

2) More of a thing will be produced in anticipation of a high price than of a low price, progressively.

Source: Harper, *Why Wages Rise*. 82

The chart above illustrates Harper's theory of how a "free price"—and only a free price—maximizes mutual benefits of exchanges. In general, to push prices artificially higher or lower will reduce the number of exchanges that take place, either by reducing demand or by reducing supply. If the good in particular is labor, then lowered employment results from wage controls in either direction. Contrary to common misconceptions, employment does not increase progressively as wages are pushed downward, rather employment decreases whenever wages are controlled artificially in either direction, according to the chart above. Based on this model the economic argument against the minimum wage is not an argument for *lower wages*, but rather for *free wages*.

What can we expect to see in the data, according to this theory? We can expect to find two distinct trends in historical data on employment. The first would be that hikes to the minimum wage result in subsequent downward pressure on employment for particular types of workers. The second trend would be that the effect of this downward pressure is magnified as the level of the minimum wage increases and as the value of labor decreases, progressively. In both cases, we will examine data from the Bureau of Labor Statistics on employment-to-population ratios, since that is the most available data on employment for the time periods and demographics under consideration.

EMPIRICAL ANALYSIS

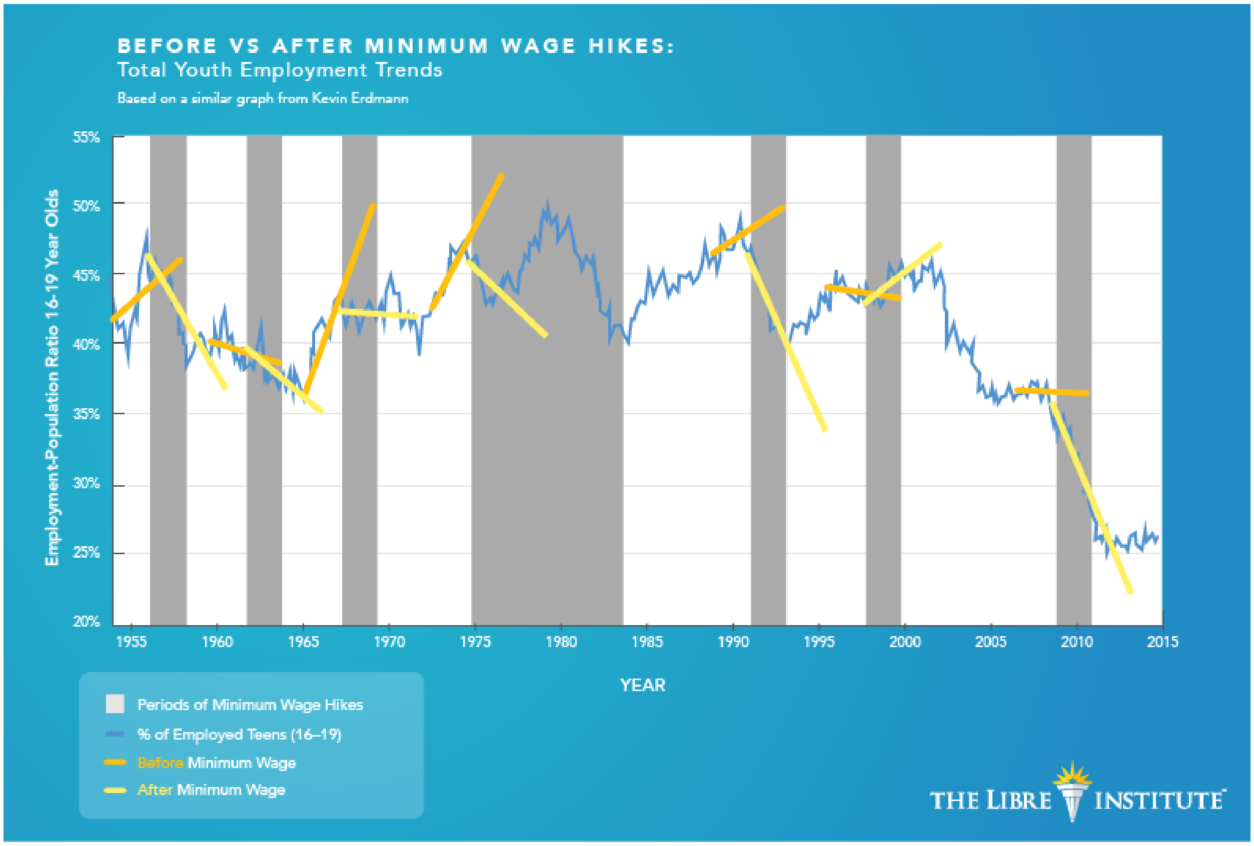
For decades, economic research generally supported the conventional view that raising the minimum wage negatively affects employment, based on arguments similar to Harper's theory above. Economists David Card and Alan Krueger challenged that convention in the 1990s, in a controversial study that examined the impacts of the 1992 increase in New Jersey's minimum wage on employment on fast food restaurants.[7] The authors conducted a survey of businesses in the area and concluded that there was no evidence that the minimum wage increase negatively impacted employment, but critics were quick to identify flaws in their methodology and called their conclusions into question.[8] While there is a long-standing and multifaceted debate in economic research over the effects of the minimum wage, the challenges of Card and Krueger have been largely rebuffed as further studies have confirmed the conventional view. Studies that focus on entire industries where negative employment effects would be expected, instead of studies that use selective data from surveys or individual companies, produce a more accurate picture of the effects of the minimum wage and confirm the consensus view. In particular, Neumark and Wascher find that studies that focus on the lowest-skilled labor groups show the strongest support for the conventional view that raising the minimum wage negatively impacts employment.[9] This report focuses on two analyses of the effects of the minimum wage on employment that have been done since the publication of the Card and Krueger study.

In order to test the first prediction of the theory—that the minimum wage will result in downward pressure on certain kinds of workers, in this case, young people—this report will examine trends in employment over time as they correspond to hikes in the minimum wage.[10] Below, a graph and analysis from the work of Kevin Erdmann displays data on the general population, followed by a similar graph from **The LIBRE Institute** that substitutes Hispanic data in order to isolate the impact on that demographic as well. In the graphics, we illustrate

[7] David Card and Alan B. Krueger, "Minimum Wages and Employment: A Case Study of the Fast Food Industry in New Jersey and Pennsylvania" (NBER Working Paper No. 4509, National Bureau of Economic Research, Cambridge, MA, October 1993), http://www.nber.org/papers/w4509.
[8] Neumark and Wascher, "The Effect of New Jersey's Minimum Wage Increase on Fast-Food Employment: A Re-Evaluation Using Payroll Records" (NBER Working Paper No. 5224, National Bureau of Economic Research, Cambridge, MA, August 1995), http://www.nber.org/papers/w5224.
[9] Neumark and Wascher, 2006: *Minimum Wages and Employment: A Review of Evidence from the New Minimum Wage Research*
[10] Erdmann, "Teen Employment and the Minimum Wage."

changes in employment trends using data from the Bureau of Labor Statistics on the US population aged 16–19 years old. The focus on teenage employment is important as a proxy for examining a particular group of workers that is likely to be impacted by hikes in the minimum wage. This is because teenagers are an age group that is disproportionately likely to take on minimum wage jobs. Younger workers are more likely to be working in low-skill (and therefore low-paying) jobs than in high paying jobs, and thus are more likely to be affected by increases in the minimum wage.

In the graph below, we consider periods of time spanning from 27 months to 3 months before a minimum wage hike to be pre-hike periods, and trend lines from 3 months before to 27 months after the initial minimum wage hike to be post-hike periods. These time intervals are selected in order to account for a significant period of time before and during each hike. A comparison of trends in employment in pre-hike and post-hike periods reveals a striking pattern.

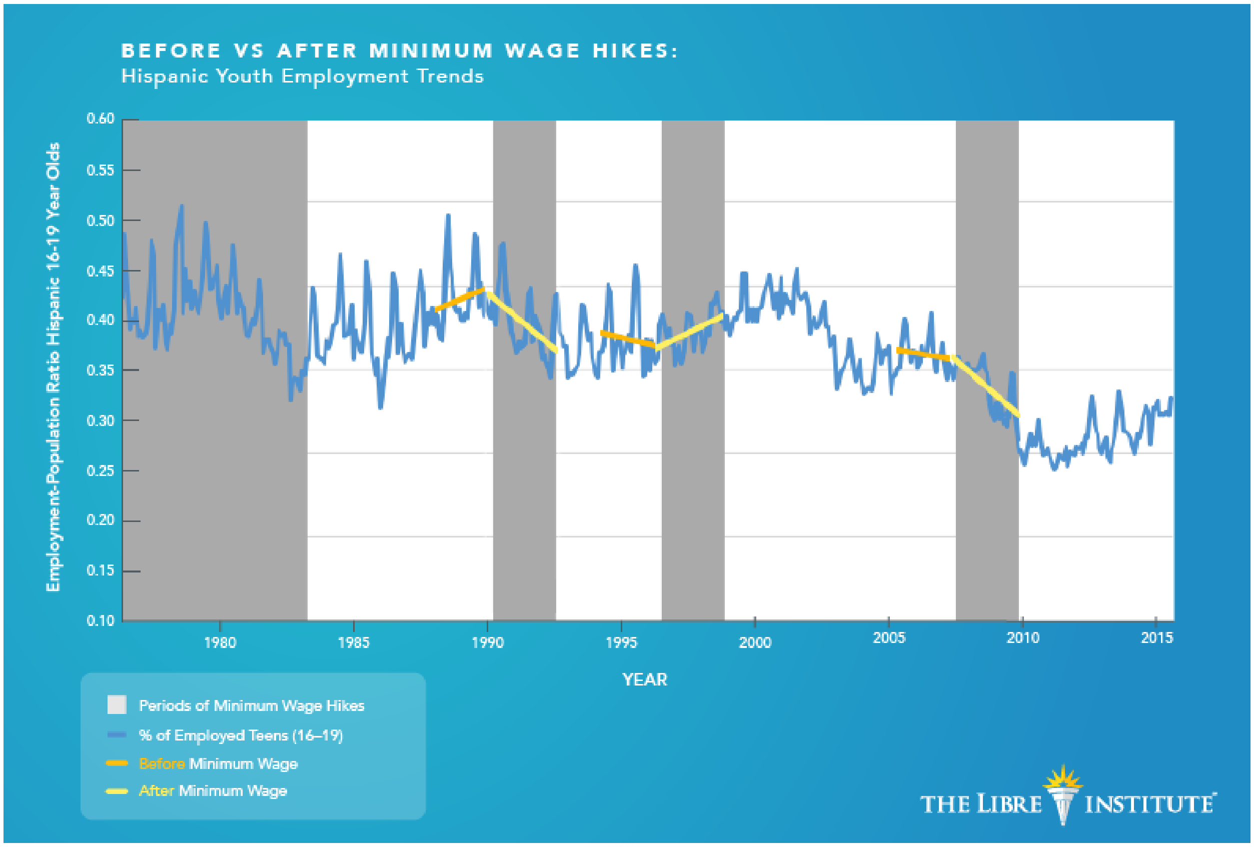


Source: Kevin Erdmann, “Teen Employment and the Minimum Wage, 60 Years of Experience,” *Idiosyncratic Whisk*

As Erdmann observes:

> In every episode except 1996 (which is the smallest hike relative to average wages), there was a distinct decline in the trend of teen employment, over the period of time covering from a few months before the initial hike until a few months after the follow-up hike.[11]

The trend in employment turns markedly downward almost every time the minimum wage is raised, which includes every minimum wage increase since 1954. Importantly, the downturns need not be negative in absolute terms in order to confirm the first prediction of our application of Harper's theory. They need only be dampened relative to the trends in employment before the hikes. So long as the slope of the line is lower in the post-hike periods than the pre-hike periods, the prediction is confirmed. These results are consistent with the idea that raising the minimum wage results in subsequent downward pressure on employment. In the version of the graph using data on Hispanics, data is not available for the entire period from 1954. However, over the period of time for which data on Hispanics is available (beginning in 1976), the same pattern emerges.



[11] Erdmann, "Teen Employment and the Minimum Wage."

Hispanic employment trends reveal a similar correlation between minimum wage hikes and dampened growth in employment. It could be objected, as Erdmann acknowledges above, that the minimum wage hike of 1996 breaks this pattern, given that it was the only hike out of the seven since 1954 that was followed by an uptick in employment. It is not surprising that Hispanic employment trends reveal this exception as well. The fact that the same pattern holds true for both populations is further reason to draw the same conclusions from the graph of Hispanic data. In addition, one of the more significant limitations of the graphs above is the fact that they do not control for the presence of recessions and the business cycle in general. Three out of the four post-hike declines in employment coincide with major economic downturns, and the extent to which the hikes were responsible for the downturns is uncertain. However, Erdmann notes that while there is some significant effect on employment trends that is attributable to recessions, the timing of these recessions does not explain why there is a consistent downward tendency in employment three months before every minimum wage hike.[12]

The observation that the exception in 1996 may be due to the fact that this minimum wage hike was the smallest relative to average wages brings us to an important limitation of our analysis thus far. Because these graphs treat the minimum wage as a binary, on-off variable, we have no way of testing the effects of higher and lower minimum wages on the employment of workers whose labor is valued differently by employers. We can only test whether there are downturns following hikes. Therefore, we must also find a way to test whether the effect of this downward pressure increases along with corresponding minimum wage increases, and as the relative value of labor decreases, progressively.

We have now confirmed the first part of our application of Harper's theory by correlating minimum wage hikes with subsequent downward pressure on employment. The following section examines the correlation between higher and lower minimum wages and the employment of higher- and lower-valued labor. In order to do this, the following section reproduces Antony Davies' comparison of three variables: the employment-to-population ratio of workers, different levels of educational attainment, and the minimum wage as a percentage of average hourly wages from 1992 to 2014. In this analysis, educational attainment serves as a proxy for the value of labor, operating on the assumption that—on a purely economic level—employers place more value on more educated workers than on less educated workers. Quantifying the minimum wage as a percentage of average hourly wages (as opposed to a dollar amount) is also significant in this analysis for two reasons. The first is that inflation changes the real value of a given amount of dollars over time, irrespective of their value on paper. The second is that the average value of labor increases across the whole market economy as the productivity of labor increases over time. As a consequence, so does compensation, which includes wages, among other things.[13] In the

[12] Erdmann, "Teen Employment and the Minimum Wage."
[13] Harper, *Why Wages Rise*.

graph below, we observe the relationship between these two variables at four different levels of educational attainment using data from the Bureau of Labor Statistics.[14]

TOTAL POPULATION

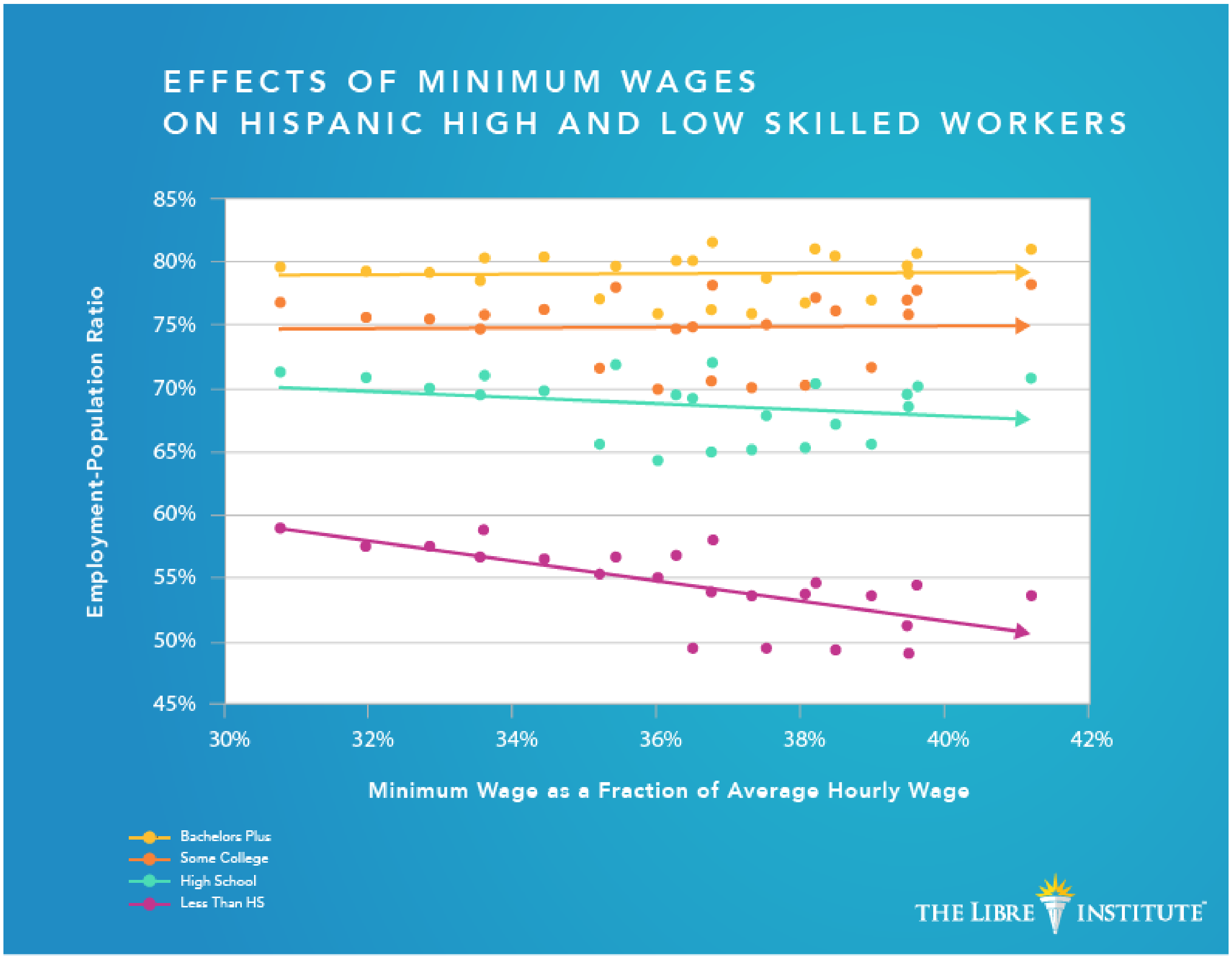
Source: Antony Davies, *Unintended Consequences of Raising the Minimum Wage,* Mercatus Center at George Mason University

From the slopes of the lines of best fit, it appears that as the minimum wage increases as a percentage of average hourly wages, employment tends to decrease at lower levels of educational attainment. The lines at higher levels of educational attainment are either flat or show a minor upward slope. As educational attainment decreases, however, the slope of the lines decreases as well, and is negative for workers without a high school diploma. Given that nearly half of all current high school dropouts are Hispanic, the tendency of higher minimum wages to push

[14] Davies, *Unintended Consequences of Raising the Minimum Wage*.

down employment for workers without high school diplomas warrants special attention to Hispanic workers.[15] Below, the employment data from the general population shown above is compared with employment data for the Hispanic population at each of the four levels of educational attainment under consideration: less than high school, high school diploma, some college, and bachelor's degree.

HISPANIC POPULATION



A comparison of the slopes of the lines for total workers with the ones using data on Hispanic workers shows that the lines representing Hispanic workers have a decreased slope at all four levels of educational attainment than those representing the total population. This indicates that the dampening effects of higher minimum wages at lower levels of education are more severe for Latinos than the total population. Unlike the

[15] Payton Alexander, "The Changing Face of America's High School Dropouts," Libre Institute, July 27, 2015, http://thelibreinstitute.org/blog/2015/07/the-changing-face-of-americas-high-school-dropouts/.

general population, there is no upward slope at all, minor or otherwise, for Hispanic employment at higher levels of educational attainment. For Latinos without college education but with high school diplomas, as well as for Hispanics without high school diplomas, employment decreases as the minimum wage increases. As educational attainment decreases, this downward tendency becomes markedly more severe, and it is worst for the least-skilled Hispanics. These observations confirm the second prediction of our application of Harper's theory, which is that the tendency of minimum wage increases to push down employment is magnified as the value of the minimum wage increases and as the value of labor decreases, progressively.

CONCLUSION

Young people and low-skilled workers, many of whom are Latino, are among the least advantaged groups in the US economy, and it is likely that a deep concern for their welfare motivates those who call for raises in the minimum wage. Everyone should have the opportunity to work hard and make a living wage, but mandated minimum wage controls do not accomplish that goal. Proponents of the minimum wage often argue that this policy will give these disadvantaged groups a raise, but their attempts to do so may result in serious unintended consequences.

Wages are not levers that set value, but metrics that reflect value. When we understand this central fact, we begin to realize the ways in which the minimum wage has the potential to hurt exactly those whom it is intended to help. Hispanic workers, like all other workers who have struggled to recover from the Great Recession, face real downturns in employment when the minimum wage is raised. As the minimum wage rises, this downward pressure worsens markedly. For the least-skilled Hispanic workers, such as those without college or high school diplomas, the effect is magnified most of all. Those who are most in need of help are the ones who are most likely to experience the unintended negative consequences of the minimum wage.

These findings are consistent with our predictions that raising the minimum wage will negatively impact employment and that this impact will be more pronounced as the value of labor decreases and the minimum wage increases, progressively. Moreover, these findings strongly suggest that raising the minimum wage will have serious unintended consequences and should significantly reduce Hispanic support for the policy. For that reason, many in the Latino community should have very strong reasons for opposing increases in the minimum wage.