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The Complex Dynamics of Raising the Minimum Wage

Both proponents and opponents of a federally mandated increase in the minimum wage are framing the issue in the wrong terms. Proponents argue that an increase is a moral imperative that will make millions of workers better off. Opponents argue that an increase will destroy hundreds of thousands of jobs.

In actuality, if the minimum wage is increased, what is more likely is:

- Few low-paid workers will lose their jobs.
- But workers who retain their low-paying jobs — and other workers as well — will likely be worse off as a consequence of the mandated increase.
- Employers will reduce non-money types of pay — primarily health insurance or other fringe benefits — to neutralize the federal mandate.
- Although few jobs may be lost, far more jobs will never be created.

Thus increasing the minimum wage may have the unintended consequence of increasing the number of workers without health insurance or with reduced benefits. Another point not much mentioned is that since an employer may try to spread the impact of adjustments across the entire workforce, it is entirely possible that benefits will be reduced for all workers, not just minimum-wage workers.

The Nature of Today's Labor Markets. Both proponents and critics of an increase in the minimum wage tend to overlook the great complexity of modern labor markets. First, workers are paid in many forms — in money obviously, but also in a variety of other less obvious ways, not the least of which are fringe benefits, workplace amenities (breaks and subsidies on purchases) and relaxed work demands. Employers will provide payments in non-money forms so long as workers are willing to give up wages and/or are willing to work harder to compensate employers for the cost of the benefits. Workers are willing to accept greater work demands so long as the resulting wage increase more than compensates for the dissatisfaction of having to work harder.

Second, market competition will always press employers to find the most cost-effective combination of payment forms.

Third, setting minimum wages does not suppress labor market competition. Rather, competition is diverted to forms of payment not covered by federal wage mandates. When one benefit is mandated, employers must respond in some other way to any market changes that occur. One response is to take away other benefits, a prospect not widely considered in policy debates.

Thus when the minimum wage is raised, employers can be expected to cut forms of payment not covered by the federal mandate — fringe benefits and workplace amenities — and, at the same time, increase work demands. If employers are willing to pay "low" wages, then they probably also will be willing to pay "lower benefits." Employers can lower benefits and increase demands because the higher pay will attract more workers to menial jobs. They also must lower benefits and/or increase work demands, or else suffer the competitive consequences of higher labor costs when other employers cut benefits and/or increase work demands.

Doubtful Improvements for Workers. After employers have adjusted benefits and work demands, should we expect minimum-wage workers to be better off on balance? The reasonable answer is "not for long." Over time, we can expect employers to cut non-money payments and make more demands on their workers. The benefits employers were providing must have been worth more to the workers than the wages they gave up in

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exchange for those benefits. When those benefits are taken away because of the forced minimum-wage hike, the workers will give up more in value from the forgone benefits than they could possibly get from the higher money wage. The higher the increase in the minimum wage, the greater the benefits withdrawn and the worse off the workers are who retain their jobs. North Carolina State University economist Walter Wessels, a minimum-wage scholar, estimates that minimum-wage workers are indeed made worse off, on balance, each time the minimum wage is hiked.

At the same time, the net effect of the higher wage, lower benefits and greater work demands — as future researchers will find — is that employment will have gone down by very little. There will be a small drop in jobs, however, due to the fact that the jobs will not be worth quite as much to the workers and will be slightly more costly to provide for employers.

So long as the wage hike is "modest," which is what the Clinton administration has proposed, the cost effect of the mandated wage hike can be largely neutralized through downward adjustments in non-wage payments or upward adjustments in work demands. The cost impact of a small wage increase can be easily neutralized today, given that the minimum wage has lost 40 percent of its purchasing power since 1968. During the past 28 years, employers have been permitted to pay lower real minimums, but that also means they have been permitted to expand the array of payment forms. What they have given in the past from lower real minimum wages, they can, and will, take away in the future because of higher real minimums.

Adjusting to Increases. A series of econometric studies over the past 15 years has shown that minimum-wage hikes do have the predicted effects: Work demands are increased. On-the-job training is reduced. Days for vacation and sick leave are cut. Year-end bonuses, severance pay and shift premiums are slashed. In general, working conditions worsen. Not many jobs are lost simply because the net increase in labor costs is far lower than the increase in the minimum wage. The econometric evidence doesn't necessarily say anything about the elasticity of the labor-market demand, but may be saying a great deal about the ability and willingness of, and necessity for, employers to adjust to government policies.

Some geographic areas and some areas of the economy tend to have a larger share of low-income jobs than others, but low-income jobs generally are held by newcomers to the job market, inexperienced people, people who are not very productive or members of disadvantaged groups. If new low-wage jobs are not created, people in these categories are not likely to be hired for higher-wage jobs because their productivity does not justify the higher cost. This non-creation of jobs because of the higher minimum wage, although difficult to quantify, not only helps to narrow the opportunities for beginners and those with limited skills but also results in lower economic growth because it reduces the expansion of existing businesses and discourages the creation of new ones.

Conclusion. The problem of elevating the welfare of the country's lowest-paid workers is far more complex than minimum-wage proponents would have us believe. A minimum-wage hike does not, and cannot, translate into a long-term improvement in welfare. The small number of job losses resulting from past minimum-wage increases is not an argument for another round of wage mandates. Rather, it is testimony to the fact that politicians do not have the market clout they think they have. The low count of job losses is also testimony to the extent to which the market has minimized the damage done by our political leaders in the election-year drives for votes.

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