

Minimum Wage Myths

Issue Brief No. 105

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February 2012

The federal minimum wage is currently \$7.25 an hour, but some states and cities have minimum wages that are significantly higher. Furthermore, eight states raised their minimum wage, effective January 1, 2012.



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Indeed:

- Vermont raised its minimum wage from \$8.15 an hour to \$8.46 an hour.
- Oregon bumped its minimum wage from \$8.50 an hour to \$8.80.
- Washington state raised its minimum wage from \$8.67 to \$9.04 — the highest of any state.
- Finally, San Francisco, which imposed a city-level minimum wage a few years ago, increased its minimum from \$9.92 to \$10.24.

Proponents of a minimum wage argue that a wage floor is necessary to lift people out of poverty, especially those earners who support families. However, the federal law sets a lower minimum for some classes of workers: tipped employees must be paid a minimum of \$2.13 an hour, and some farm workers are exempt.

Some people argue the minimum wage is not enough, and have proposed more generous “living” wages. A living wage aims to provide a minimum standard of living, accounting for the cost of housing and basic needs for an individual, or even a family of three or four. Some New York City officials are considering a bill requiring local businesses that receive government contracts to pay a “living” wage of at least \$10.00 an hour, or \$11.50 an hour if they don’t offer their employees health insurance. Los Angeles already requires companies that contract with the city or operate on city property to pay a living wage of \$9.64 per hour with health benefits or \$11.84 per hour without.

Who Earns the Minimum Wage? Minimum wage workers are more likely to be teenagers, college students or part-time/full-time secondary earners, rather than heads-of-households supporting families. According to the Bureau of Labor Statistics:¹

- About half of minimum wage workers are younger than age 25.
- Never-married workers are more likely to earn the minimum wage than married workers, and never-married workers tend to be young.
- Part-time workers are more likely to earn the minimum wage than full-time workers.

Minimum Wage Myths

- Among hourly workers age 16 and over, those with no high school diploma were more likely to earn the minimum wage than those with a high school diploma or college degree.

More education, more years of work experience, and more hours worked per week reduce the chance of earning the minimum wage.

Minimum Wages and the Cost of Living.

Proponents also argue that a higher minimum wage will help lift people out of poverty by offsetting the higher cost of living in some areas. For example, San Francisco, which has the highest minimum wage in the nation, has the fourth highest cost of living among major metropolitan areas, according to the Council for Community and Economic Research (C2ER).²

Figures I and II show C2ER's top 10 most expensive metropolitan areas (third quarter, 2011) and the 10 least expensive metropolitan areas. The local minimum wage varies widely:

- Washington, D.C., and three states where the most expensive areas are located have higher minimum wages than the federal level.

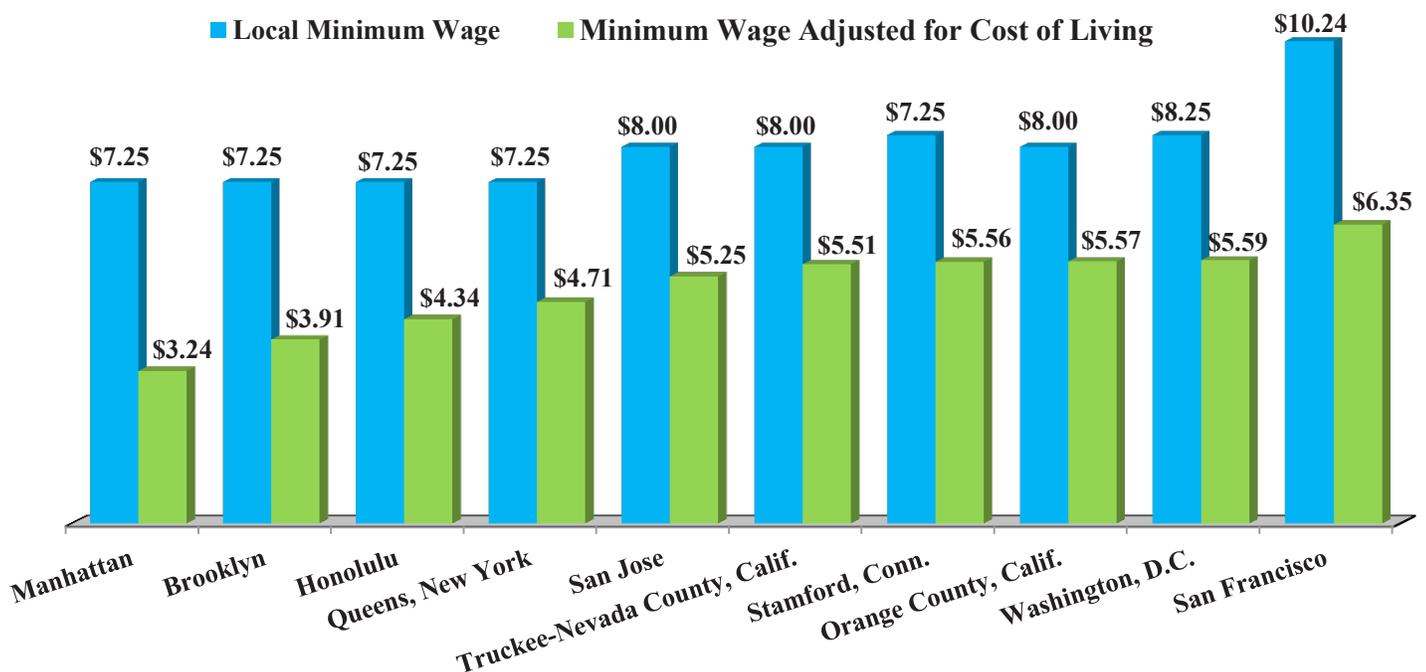
- In states where the least expensive areas were located, none has a higher minimum wage than the federal minimum.

After adjusting for the cost of living:

- New York City's minimum wage has the buying power of a paltry \$3.24 an hour in Manhattan — the lowest effective wage of any metropolitan area.
- San Francisco's \$10.24-an-hour minimum wage buys only \$6.35 worth of goods and services.
- On the other hand, the federal minimum wage in low-cost Harlingen, Texas, will buy \$8.87 worth of goods and services.

A higher minimum wage raises labor costs to employers. But this does not mean that the minimum wage is solely to blame for the cost of living in New York City or San Francisco. After all, desirable location

Figure I
Value of Minimum Wage in 10 Highest Cost of Living Areas



Source: "COLI, 3rd Quarter 2011," Council for Community and Economic Research and author's calculations.

Figure II
Value of Minimum Wage in 10 Lowest Cost of Living Areas



Note: Actual federal minimum wage is \$7.25.

Source: "COLI, 3rd Quarter 2011," Council for Community and Economic Research and author's calculations.

raises costs. Regulations that restrict the supply of housing raise costs. Impact fees that raise the cost of building are passed on to buyers and consumers.

Minimum Wage as a Stimulus. Proponents also claim that higher pay means low-wage workers will have more to spend on goods and services, thus boosting the economy. But if employers cannot absorb an increase in the cost of labor, they will hire fewer workers, hire more productive (educated) workers, lay off workers, or pass the costs on to consumers. Thus, the stimulative effect on demand may be offset by reduced employment among potential consumers. According to the Bureau of Labor Statistics:³

- The unemployment rate among workers age 24 and younger was over 16 percent in November 2011, more than twice the rate of workers age 25 and older.
- The unemployment rate for those with less than a high school diploma was 13.2 percent, compared to 8.8 percent for those with a high school diploma.

Lower-skilled or young workers who find themselves out of work or unemployable do little to boost the economy.

Declining Labor Force Participation. Several studies have attempted to measure the effect of the minimum wage on employment, and with different conclusions. While some studies found no adverse effect of the minimum wage on employment, a 1995 study by economists Dave Neumark and William Wascher found that increases in the minimum wage have an adverse effect on teenagers:⁴

- First, increases in the minimum wage increase the probability that teenagers will leave school and search for employment.
- However, the probability of teenagers being employed falls, as less-skilled workers are replaced by more-skilled workers.
- Thus, many teenagers who leave school in order to work will find themselves out of work and out

of school, and the probability of them being unemployed over long periods of time increases.

The employment outlook for young workers who are most affected by changes in the minimum wage has declined over the years. In July 2008, the unemployment rate for 16- to 24-year-old workers was 14 percent, compared to 18.1 percent in July 2011. This was an improvement over the 2010 rate, when unemployment peaked at 19.1 percent, but there are other troubling factors to consider:⁵

- The population of 16 to 24 year olds has increased since 2008, but the labor force participation rate among this group has dropped from 65.1 percent in 2008 to only 59.5 percent in 2011.
- Furthermore, the unemployment rate among some minority groups in 2011 was particularly high: 31 percent for African-Americans and 20.1 percent for Hispanics, compared to 16 percent for whites and 15.3 percent for Asians.

In some urban areas, the unemployment rate for teenagers is exceptionally high. For instance, the teenage unemployment rate in Washington, D.C., is 50 percent, the highest in the nation.⁶

Conclusion. Minimum wages are politically popular, but distort the labor market and hurt the

people they intend to help. Reforming the education system and promoting characteristics that increase individual wages — such as finishing high school and improving skills through college or trade/vocational schools — would do more to lift people out of poverty than mandating wages.

Endnotes

1. “Characteristics of Minimum Wage Workers: 2010,” Bureau of Labor Statistics.
2. “COLI, 3rd Quarter 2011,” Council for Community and Economic Research.
3. “Table I: Employment status of the civilian noninstitutional population 16 to 24 years of age by sex, race, and Hispanic or Latino ethnicity, April-July 2011,” Bureau of Labor Statistics.
4. David Neumark and William Wascher, “The Effects of Minimum Wages on Teenage Employment and Enrollment: Evidence from Matched CPS Surveys,” NBER Working Paper, #5092, April 1995.
5. “Table 2. Employment status of the civilian noninstitutional population 16 to 24 years of age by sex, race, and Hispanic or Latino ethnicity, July 2008-2011,” Bureau of Labor Statistics.
6. Penny Starr, “Average Teen Unemployment Rate in D.C. is 50.1%, Analysis Shows,” CNS News, August 12, 2011.

About the Author

Pamela Villarreal is a senior fellow with the National Center for Policy Analysis. Villarreal is an expert on retirement, Social Security, economic growth and tax issues and has authored studies and analyses on specific topics, including the danger of 401(k) borrowing, Social Security disability, the expiration of tax cuts and the future of Social Security and Medicare.

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