

STILL A BAD IDEA

State Shouldn't Try to Force Up the Minimum Wage

Summary: The NC House is considering a bill to raise the state's minimum wage to \$8.50 an hour. While intended to help lower-income workers earn a "living wage," the more likely result is to boost the earnings of some non-poor workers, including many teens and seasonal workers, while increasing the unemployment rate for many poor and minority workers. Employers will not hire people whose work efforts are worth less in the market than a government-imposed wage. A better policy to boost the earnings of entry-level workers would be to address their educational deficiencies, the product of ineffective schools.

The North Carolina House of Representatives is currently considering legislation to raise the government-imposed minimum wage in the state over a three-year period to \$8.50 an hour. This is a full \$3.35 an hour above the federal minimum. Specifically, the bill would phase in the increases from its current \$5.15 an hour to \$6.15 on September 1 of this year; then to \$7.15 in September 2006; and finally to \$8.50 in September 2007. The short title is "The Living Wage Act," and apparently the theory is that those at the lower end of the economic ladder should earn enough to support a basic standard of living.¹ In practice, setting an \$8.50 minimum wage makes no economic sense and will probably harm the very people it is meant to help.

The Economics of Wage Floors

It is commonly believed that economists never agree on anything. But in a recent survey of American Economic Association labor economists, 80 percent agreed that living-wage laws punish low-skilled and poorly educated workers.² To see why this is so, it is important to recognize the economic basis of the employer-employee relationship, which is an exchange of value for value.

To employers, wages represent the most significant, but not the only, component of the cost of hiring someone. Other components include the employer's share of Social Security and unemployment insurance and the cost of health or retirement benefits. An employer will hire someone only if the total cost of hiring that person is less than the value of the person's productive output. It makes no sense for an employer to do otherwise. If a company consistently hired workers whose output was not as valuable as their hiring costs, it would suffer losses and eventually go out of business.

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So what are the likely effects of increasing the minimum wage in North Carolina to \$8.50 an hour? Those with work skills so low that the value of their productive efforts is below the total cost of hiring them won't be hired. As noted, the minimum wage understates this full cost. A conservative estimate would be about \$10 an hour in total compensation.

Essentially, the proposed law would discriminate against people whose productive output is less than \$10 per hour and in favor of those whose work efforts are valued more highly in the market. A well-known effect of minimum wages is to price lower-skilled workers out of the market and increase demand for higher-skilled workers.

That is why all-white labor unions in segregated South Africa favored minimum-wage laws; such laws excluded competition from lower-skilled black laborers.³

Living-wage laws ensure that the least-educated and least-experienced workers in our society will receive no wage at all. Nationally, more than 30 percent of those earning under \$8.15 an hour are high-school dropouts. It should be clear to anyone who has looked past a knee-jerk desire to raise people's wages that simply mandating a higher minimum wage cannot make these workers' labor more valuable to employers. Consistent with this analysis, recent empirical estimations have concluded that each 10 percent increase in the minimum wage causes a 2.9 percent decrease in the likelihood of finding employment.⁴ This implies that the new "living wage" being proposed for North Carolina will reduce the likelihood that a low-skilled person will be able to find a job by nearly 19 percent.

It is often suggested that a large proportion of minimum-wage workers are parents in single-worker households struggling to eke out a living. This is not true. Such workers represent the smallest share of minimum wage workers. Only 17 percent of the state's workers earning at or near the minimum wage — between \$5.15 and \$7.00 an hour — are sole income earners in families with children. Given the economic analysis above, it is likely that these parents would actually be made worse off by the legislation. Clearly some of them, whose work skills and experience are probably quite low, will no longer be profitable to employ. It is likely that at least some of them will lose their jobs. A recent study by two Duke University researchers found that current minimum-wage employees end up with a higher probability of unemployment after a hike in minimum wages.⁵ The highest percentage of those paid at or near the minimum wage are workers living with a parent or relative. This would obviously include a great many teenagers from middle- and upper-income families. The remaining 47 percent are from dual-income families or are either single or married with no children.⁶

Conclusions

The important question is why are there many people in our state lacking the education and work skills necessary to command a wage that is significantly above the minimum. Unfortunately, the same people who are vocal about low wages for unskilled workers rarely ask this question, because the answer points directly toward what is their sacred cow: the current, government-run school system. Nothing correlates more closely with higher wages than job skills and education. For the most part, government schools serve white, middle- and upper-middle-class children adequately, while failing dismally those who need it the most. This failure prevents many young people from gaining the skills that would ultimately bring them a higher wage in the marketplace.

— Dr. Roy Cordato, Vice President for Research and Resident Scholar

Notes

¹ "An Act Amending the Wage and Hour Act to Raise the State Minimum Wage to a Livable Wage" (Short title: "Living Wage Act"), House DRH 70098, General Assembly of North Carolina Session 2005.

² "The Living Wage: Survey of Labor Economists," The Survey Center, University of New Hampshire, <http://www.unh.edu/ipssr/survey-center/>, August 2000. Survey published by the Employment Policies Institute at www.epionline.org.

³ See Walter E. Williams, *South Africa's War Against Capitalism*, (New York and London: Praeger) 1989.

⁴ Peter Arcidiacono and Tom Ahn, "Minimum Wage and Job Search: What Do Employment Effects Really Measure?" found at www.epionline.org

⁵ *Ibid.*

⁶ Found at http://www.epionline.org/mw_statistics_state.cfm?state=NC.

