MINIMUM WAGE DISCUSSIONS

Since 1 January, 1981, the United States has carried a minimum wage of $ 3.35. Debate continues over the justification of the increased limit. Because this legal requirement has a direct impact on the labor market, increases in the wage deserve ample investigation. Some feel the laws are a "common sense" solution to the problems of the lower income workers. Others, mainly neo-classical economists, are less enthusiastic, viewing the attempt to obtain social objectives by interfering in the market place via minimum wage laws as being a sincere effort having unintended negative results.

Through various styles, most nations have established minimum wage legislation. In 1938, the United States enacted the **Fair Labor Standards Act** (FLSA), designed to lift the working condtions of American labor. A "floor under wages" was created by the FLSA at twenty five cents per hour. The law covered twenty five per cent (25%) of the total labor force. (1) Since then, coverage has been expanded by the government to include a much greater share of low income workers.

ON THE POSITIVE SIDE

There are strong arguments for a minimum wage. To be sure, it protects vulnerable workers. Secondly, it gives rise to a "fair wage" for less skilled laborers. Further, it provides a floor to the wage structure. The minimum wage

1 Robert T. Falconer, "The Minimum Wage: A Perspective," <u>Federal Reserve Bank of New York Quarterly Review</u>, Autumn 1978, 3 (3), pp.3.

also aids in the achievement of macro-economic goals like stability, growth, and distribution of income. Quits have been shown to decrease with increased wage floors. Finally, in a normative sense, the legislation is considered "good," mainly because it is popular.

Some groups in the labor market have a very poor bargining position. Similarly, specific classes of people like women, migrants, children, teenagers, and homeworkers, present uniquely vulnerable situations. Minimum wage laws can provide for and protect these people in need of outside assistance.

By creating a "fair wage," labor seems to be paid a "proper" amount for their endeavors. "Unfair" competitive practices by employers are reduced as a "common market wage" is applied to all workers.

The minimum wage acts as a "net" preventing wages from falling excessively low. A small number of workers, within certain industries, would receive dramatically lower incomes "... because of the apparent lack of an acceptable alternative (if the minimum wage did not exist)"(2) By preventing an unacceptably low wage, safeguards for the protection of the workers are created. In this manner, a wage floor can help curb poverty.

As a macro-economic instrument, it is believed by some economists, that the minimum wage rate can be used to achieve

2 Gerald Starr, "Minimum Wage Fixing: International Experience with Alternative Roles," <u>International Labour Review</u>, September-October 1981, pp. 549.

economic goals. Possible objectives include stability, a "better" distribution of income, and growth.

In unregulated markets, many workers will receive a wage below equilibrium, due to inequalities in bargaining abilities. With these lower rates is accompanied a lower standard of living and a decrease in purchasing power. Furthermore, the wage rate may fluxuate over a wide range, causing radical shifts in demand. These changes are contradictory to stabilization goals of the aggregate economy. Thus, in a regulated market, it is argued that minimum wage legislation promotes increased stability.

Stability is further enhanced as a disparate group of wage rate decisions come under the jurisdiction of policy makers. Wages fall in line with national goals, both social and economic. This, of course, entails augmented responsibility on the part of the government authorities to establish a rate consistant with the economic goal of stability.

In addition to helping obtain stability, FLSA also generates a "more fair" distribution of income. As stated earlier, the law can help to raise low wages. More importantly, however, it can work to diminish the differences in income between various industries and between differing companies. With careful economic planning, economist Gerald Starr maintains a better distribution can be obtained without a corresponding increase in unemployment.

Growth is another possible effect of minimum wage legislation. By stabilizing wages, government also produces an environment with greater growth potencial. Achieving this goal, however, may restrict some of the thrust towards a more fair distribution of income. Again, it is also clear that the use of legislation to obtain the economic goal of growth can be problematic for policy makers who ultimately must juggle an assortment of difficult and often conflicting economic issues.

Another apparent consequence of the minimum wage regulation is its effect on quits. As the benefit of changing to a new job falls, it becomes less likely an employee will discontinue employment. Therefore, (as is explained in "Search Theory") as wage rates increase, benefits from search dwindle. In addition, in the presence of increased regulation, business may become more selective in hiring, taking on people only when there exists more assurity of continued employment. That an inverse relationship between quits and increases in the minimum wage exists is imperically founded.(3)

The popularity of the minimum wage among the populace is no secret. Politicians seem to capitalize on the issue each election year. In fact, in 1973, Silberman and Durden discovered that the greater percentage of low income workers

3 Wilson J. Mixon, "The Minimum Wage and Voluntary Labor Mobility," Industrial Labor Relations Review, October 1978, pp. 69.

in a particular congressional district, the greater the support for higher minimum wages. One might think that the "unemployment effect," the rise in unemployment among low income workers during an increasing minimum wage, would cause a disfavorable response in areas of lower wages. However, Silberman and Durden suggest that lay-offs experienced in recent years as the result of increased wages has declined when contrasted with earlier periods. Thus, support remains high for the legislation .(4)

PROBLEMS

Despite the benefits derived from the minimuum wage, many economists retain doubts about the motivation of the legislation. The lower classes seem to be hurt by increases in unemploymet. Inflation also tends to pick up as the lowest legal wage is incremented upward. Furthermore, decreases in market efficiency result.

Many economists feel the lower classes are injured by increases in the minimum rate. While the laws are created to help the less advantaged, unemploymet tends to creap upwards as wage rates clime. Employers are forced to substitute the now relatively less expensive capital for the increasingly expensive labor. Also, fewer, more specialized individuals will be hired as opposed to more numerous but less skilled workers. Employees with productivity below a new wage foor will be let go. These individuals tend to be less skilled

4 Garey C. Durden, and Jonathan J. Silberman, "Determining Legislative Preferences on the Minimum Wage: An Economic Approach," Journal of Political Economy, April 1976, pp. 3117-29.

persons, youths, and minorities.(5) Thus, while the minimum wage does raise incomes for many marginally productive laborers, it involves the social cost of lost jobs. Helping some disadvantaged people comes at the expense of hurting equally unfortunate persons.

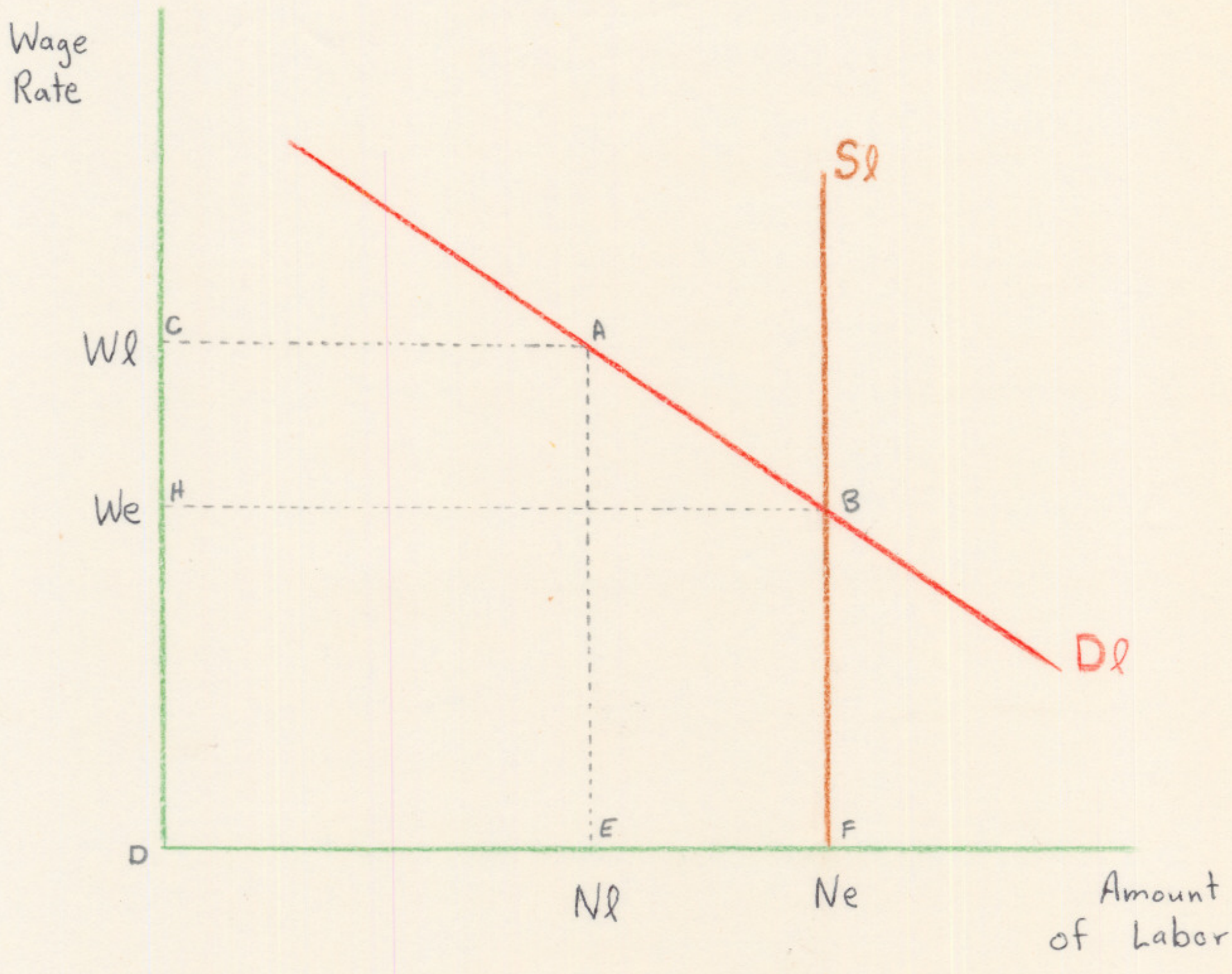
Workers have been divided into three groups. Two groups, the "core" and the "irregular," are not affected by changes in the minimum wage. The core workers are hired under rigid market conditions, where the demand for labor is determined by contracts, unions, and other forces. Similarly, the irregular labor pool remains unchanged by increases in the wage floor.

The third group, the periphery, suffers most from increases in the wage rate. The market for periphery labor is very competitive and sensitive to change. As the price of labor increases, this group is the first to incur loss of jobs.

Graph number 1 illustrates an increase in the minimum wage. Let "Dl" be the demand for labor, "Sl" be the supply of labor, "Ne" be the number of workers employed at equilibrium, "We" be the market equilibrium wage rate, and "Wl" be the number employed at the new legislated minimum wage.

Assuming Wl to be greater than We, as the wage rate increases, **all other things being held constant,** the number

5 Falconer, op. cit., p. 4.



"Increased Minimum Wage"
graph 1

employed falls from Ne to Nl. Furthermore, assuming the demand for labor to be very sensitive and therefore elastic near the minimum wage rate, at equilibrium, entire payments to labor will equal (Ne X We), or the equivilant to the area labeled (HBDF), while an increased wage results in payments equal to (Nl X Wl) or (ACDE). With a higher minimum wage, **total** payments to those receiving minimum wage decreases.

Unions appear to benefit from increased wages. As the wage rate shifts upward, skilled workers are hired in favor of unskilled labor. Because skilled persons are more likely to be union members, the syndicates gain membership and strength at the expense of non-union workers.

Inflation is yet another side effect of increases in the minimum wage. As employers' expenses increase, prices also rise, representing cost push influences. Demand pull forces result as workers have increased purchasing power and "too much money is chasing too few goods." Yet, it is argued this can be avoided if the law is used to follow market trends, not lead or set trends.

The inflationary debate is complicated by empirical evidence. Minimum wage increases often "...lead to a rise in the wages of others as the entire pay structure of many or industries is adjusted to the higher base pay." (6)

6 Falconer, op. cit., p.5.

Market efficiency suffers from minimum wage legislation. As stated earlier, quits become less frequent the greater the floor on the pay scale. With this, mobility of labor is decreased. Furthermore, the dynamic efficiency of the entire labor market decreases as employers are, in some cases, forced to pay workers at a rate above the equilibrium level. It follows that if higher rates are mandated by law in one area, another area must shoulder the burden of the increased expense. The result will be a misallocation of resources. Again, however, proponets of the minimum wage assert if the law is used to follow trends and not set them, market efficiency will not suffer greatly.

CONCLUSIONS

As could be expected, economists draw different conclusions about increases in the minimum wage. Some experts give the legislation positive reviews, offering suggestions for improvement. On the other hand, critics feel the legal limits should be lowered or eliminated.

Youth proposals have been made to improve the system. By offering the young special privileges, it is hoped that they, who are in need of special protection, can be taken care of. This may entail specific legislation raising wages for this individual group only.

Student proposals have a particular appeal. Because they help students of all ages and not simply youth, a broader range of protection can be obtained, increasing the benefits of enforced wage floors. To be sure, both student and youth proposals accomodate the needs of many having only limited skills. In addition, both suggestions contain the positive qualities of a less comprehensive legal wage base, as well as the problems the legislated mandate presents.(7)

At least two schemes are possible to help youths and students. Newly hired workers and teenagers could work for a subminimum wage, allowing fexiblity to the program and minimizing job loss. Low productive workers, in another program, could be paid a subsidy by the government to compensate for low wages. Clearly, however, an increase in the level of skill among low income persons through education and/or training is an optimum solution.

International Statutory Minimum Wage Fixing (MWF) has been pushed by a number of economists, including Gerald Starr. The advantage of this concept is the extension of the benevolent results of the regulation to people, not of just a single nation, but to all nations. Unfortunately, the malevolent effects also accompany the laws and if it was difficult to find agreement and support for the minimum wage within a single country, how much harder will it be to get a group of nations to come together and unite under a common set of rules, eventhough these same rules might promote desireable economic and social results for all involved en-

7 National Association of Pro America, resolution for the exemption of youth from the minimum wage, Congressional Record, E 1745, vol. 128, no. 45, April 22, 1982.

tities.

In contrast to those supporting a concept of a higher or more specialized minimum wage program, believing it helpful, detractors feel the plans are more harmful and should be eased. Some would like to see the minimum wage lowered, while others would prefer it eliminated all together. These economists affirm the belief that wage floors do more harm than good. The very people it is designed to help would be better off in the absence of such a policy, or at least with a lower floor established.