The Counterintuitive Workings of the Minimum Wage

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Ideas

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The Biden administration and House and Senate Democrats want to raise the national minimum wage from $7.25 an hour to $15 an hour. The result would be straightforward: higher wages, but also the closure of mom-and-pop stores; higher prices on everything from gas-station tacos to day care; a rise in unemployment, particularly among teenagers; and strain in low-wage, rural economies.

That, at least, is the argument being made by many economists, businesses, lobbying groups, and conservative politicians as the proposal comes under congressional consideration. It is an intuitive one. Democrats are proposing to more than double the wage floor to its highest-ever level, asking tens of thousands of businesses to give large raises to millions of workers. Make something more expensive, people buy less of it; make the wage floor higher, businesses will buy less low-wage work.

Yet minimum wages have a way of screwing with economic intuition, and complicating the simple logic of supply and demand. The benefits of a $15 minimum would greatly outweigh the costs. More than that, new economic evidence suggests that those costs might be small ones anyway: Even in low-wage, low-density, low-cost-of-living parts of the country, a $15 minimum might not be a death knell for small businesses or a job killer for low-wage workers.

The Democrats are pushing to raise the wage floor to $15 by 2025. Although only 2 million workers earn the minimum wage or less today, roughly 23 million workers would get a pay increase if the plan were to become law. In addition, Democrats are pushing for the elimination of the tipped minimum wage. Waiters, bartenders, and the like, who now get as little as $2.13 an hour directly from their employers, would make $15 an hour too. They also want to index the minimum wage to inflation, so that workers would get a raise as prices creep up.

The proposal has raised three major sets of concerns. The first is jobs: Many businesses might not be able to make the pay-hike mandate work without laying off employees or not hiring them in the first place. The Congressional Budget Office has estimated that a $15 minimum wage would reduce payrolls by 1.3 million workers, squeezing the country's overall employment level by 1 percent and the number of low-wage jobs by 7 percent. Those job losses would be concentrated among the people who want but cannot get anything other than very low-wage jobs in the first place, meaning teenagers and other younger workers, women, Black and Latino workers, and immigrants.

Annie Lowrey: How the low minimum wage helps rich companies

"It's a slam-dunk case that a $15 minimum wage would be devastating to low-wage workers in much of the country, even after the economy has fully recovered from the pandemic recession," Michael Strain, an economist at the right-of-center American Enterprise Institute, has argued.

Three decades ago, this was conventional wisdom. But not now. A large body of research has upended the old consensus that higher minimum wages necessarily reduce employment. One recent survey, for instance, examined 138 minimum-wage hikes at the state level and found essentially no effect on payrolls. The open question is how high is too high, Arindrajit Dube, a co-author of that paper and a professor at UMass Amherst, told me.

He and others contend that it might be higher than you would think. The study he worked on showed that setting the minimum wage at up to 59 percent of average wages has no effect on employment. A separate study of minimum-wage hikes in low-wage areas by researchers at UC Berkeley found that setting the floor as high as 80 percent of average wages has no effect either. (Fifteen dollars an hour is roughly two-thirds of the national average wage, and 80 percent of the average in the lowest-wage states, like Mississippi.) Examinations of wage hikes in other countries also suggest that a high minimum wage would not cause major job losses.

"Can we say with full assurance what the employment impact will be? No," Dube said. "But our evidence base has been fast growing in the past five years, and ambitious minimum-wage policies—they haven't been having a clear impact on low-wage employment so far."

Even if the $15 minimum wage were to shrink payrolls in some places, low-wage workers—including those who experience joblessness—would still end up better off financially. Low-wage jobs tend to have tons of churn: Workers quit, get hired, and leave or get fired frequently. In any given month, one in ten low-wage workers leaves or starts a gig; fast-food restaurants have annual employee-turnover rates as high as 150 percent. That means a large share of low-wage workers experiences a spell of unemployment in any given year. Raising the minimum wage might extend that period of unemployment, Heidi Shierholz, the former chief economist at the Department of Labor, told me, as competition for the jobs heats up. But a worker earning $15 an hour for six months is still better off than a worker earning $7.25 an hour for twelve months.

Annie Lowrey: The underemployment crisis

How about restaurants, which will be asked to cope not only with a shift to a high minimum wage but also with the elimination of the tipped minimum? The food-service industry, battered by the coronavirus recession, is among the most vocal protesting Joe Biden's proposed policy, arguing that both of those changes would put many restaurants out of business.

But the tipped minimum is a terrible policy. It promotes racism, sexism, lookism, and ableism in the workplace. It facilitates harassment, as waiters, bartenders, and other tipped employees are forced to put up with guests' obnoxious or even dangerous behavior because their livelihood depends on it. It also allows for wage theft. In many states, tipped employees are supposed to be guaranteed an hourly minimum by their employers. But one in six restaurants stiffs its workers of that guarantee, a Department of Labor investigation found; five in six violate one wage-and-hour law or another.

Getting rid of the tipped minimum would task companies with adjusting their business models. Prices would have to increase; pay scales would have to change. But a number of states, including California and Minnesota, do not have a tipped minimum. Their restaurant and hospitality industries still manage to operate just fine. Moreover, studies have shown that the tipped minimum has an "insignificant" impact on employment overall.

And if Biden's $15 minimum leads to some declines in employment, the government could soften the blow. Uncle Sam could push more money into subsidized- or guaranteed-jobs initiatives for teenagers and formerly incarcerated individuals, for instance. Congress could nationalize and enhance the unemployment-insurance system. Washington could commit to reducing the jobless rate through expansionary monetary and fiscal policy. "Run the economy hot," Dube said. "That's going to be the best full-employment plan."

Policy makers could also create an option for states to delay planned minimum-wage increases if they were causing too much joblessness, to let the labor market catch up. “It is not like you are going over a cliff,” with a too-high wage floor inculcating a recession, Dube said. “It’s like you’re cresting a hill.”

A second set of concerns has to do with high minimum wages forcing companies out of business or giving them cause not to open in the first place—not so much the big national chains that hire lots of minimum-wage workers, such as dollar stores, but mom-and-pops with thin operating margins and less access to credit. A $15 minimum might devastate corner delis, Laundromats, hair salons, day cares, and other businesses with price-sensitive customers and high labor costs, the theory goes, with Black-owned and woman-owned businesses particularly hard hit.

Companies might not like higher minimum wages, but they don’t need to like them to live with them. Firms have many options for adapting to higher labor costs, and they use them, a large body of research shows. They tend to raise prices on whatever they are selling, for one, whether sandwiches or manicures or yard work or elder care. In that way, they pass the cost of minimum-wage increases onto their customers. They also get more productive, using their workforce better and benefiting from lower employee turnover, improved morale, and higher worker output. Finally, they can accept lower corporate profits.

That said, some businesses might not be able to make the math work with a higher wage base. Those tend to be businesses that were struggling to begin with and might not have made it anyway. The minimum wage seems to be Darwinian, driving weak competitors out: One study, for instance, showed that a company with a 3.5-star average on Yelp is more likely to fail after a minimum-wage hike, but a five-star company is not.

Is it worth keeping the minimum wage low to save those firms, or to keep profits high at others? Stepping back even further: Does it make sense to allow businesses offering poverty wages to flourish? Do we want, as a society, to have an economy made up of businesses that rely on poverty wages? The answer, I believe, is clearly no.

Relatedly, some worry that higher minimum wages will disproportionately burden low-wage, low-cost-of-living rural areas, particularly in the South. But in many one-stoplight towns, the predominant employers at the minimum wage are not independent farms, town-square barbers, and the like. They are consolidated megacorporations, such as Walmart, Dollar Tree, McDonald’s, and Tyson. These firms’ market power—and Washington’s acquiescence—lets them suppress wages, because workers have so few employers to choose from and are pitted against one another for pay increases. Higher minimum wages would counter these firms’ monopsony power.

The racial dynamics are important here, too: Poorer, lower-wage regions tend to have more Black workers. Keeping minimum wages low means keeping poor places poor, keeping Black families poor, and keeping the gap between Black and white families wide.

Finally, there is the concern that higher minimum wages will lead to inflation: Hello, $15 minimum wage; hello, $15 takeout sandwich. Again, these concerns are overblown. Businesses do pass the higher labor costs associated with minimum wages onto consumers. But the price increases tend to be quite small—a buck more for a sandwich, 50 cents more for a taco, a few dollars more for yard work. One study, for instance, found that for every 10 percent increase in the minimum wage, prices for food consumed outside of the home rise just 0.36 percent.

The impact would not be big enough to have more than a marginal effect on prices or on the country's overall rate of inflation. "A really large part of the incidence of the minimum wage shows up in higher prices, and the contribution of minimum-wage jobs to the [country's rate of inflation] is very, very small," Dube said.

These are the supposed deleterious effects: somewhat less employment, perhaps, which could be offset with other policies; the faster failure of some weak businesses and the end of those truly reliant on poverty wages; modestly higher prices on some goods. The debate in Washington tends to focus heavily on that first metric, but it is not the only one. Nor is it the most important one.

The question is what kind of economy we want to have, what kind of jobs we want to promote, and how much poverty we want families in relatively low-wage—and often brutally difficult, emotionally draining, physically tiring, and societally essential—jobs to experience. Right now, our policies do not just allow, but promote, destitution. We choose to have a large precariat, with tens of millions of families both working and poor. The $15 minimum would make it possible for such families to get by, if not thrive.

Indeed, all the focus on the drawbacks has overshadowed the good that higher wages would do. A $15 minimum wage would lift 1.3 million people out of poverty, half of them children. It would push an additional $8 billion a year in earnings to families below today's poverty line, and another $14 billion a year to households just above it. Millions of people would find it easier to put food on the table and gas in the car.

At no cost to the government either—there's no better deal for the taxpayer in economic policy. The earned-income tax credit lifts roughly 6 million people out of poverty per year, at a cost of roughly $70 billion. With a higher minimum wage, Uncle Sam would lift more than 1 million people out of poverty annually while saving as much as $100 billion.

Second, the $15 minimum would reduce the country's wage inequality, redistributing income from corporate executives and shareholders down to janitors, cashiers, fry cooks, and care workers and moving families into the middle class. Indeed, the failure to lift the minimum wage from its current level accounts for roughly half of the inequality between women at the bottom and women in the middle of the wage distribution. The policy would help reduce the gender wage gap and the racial wage gap, too, as well as helping the poorest parts of the country catch up.

Third, a higher minimum wage would support the creation of good jobs throughout the economy. In response to a higher wage floor, companies would have to make positions more interesting, more creative, more productive; they would have to invest in better equipment, and anticipate lower employee turnover. The higher minimum wage might even help nudge up productivity across the economy: High wages helped foster the great productivity boom that occurred in the 1940s and ’50s, some economists believe.

Last, Americans want this policy—Democrats and Republicans, rural voters and urban voters, coastal states and central states. In a time of great polarization, few things have the universal popularity that higher wages do. Workers want them. Voters love them. Employers hate them. Yet nobody has much to fear from them. That should be reason enough for the Biden administration to go make work pay.