House Labor and Industry Committee, Informational Meeting

February 6, 2019

Antony Davies, Ph.D.
Associate Professor of Economics, Duquesne University

Thank you for inviting me to address the committee. As much as we might wish it were otherwise, the laws of economics apply to the labor market just like they apply to every other market. I'm not equating people and products. I simply mean that the forces that drive people's behaviors when they buy and sell products are the same forces that drive their behaviors when they look for jobs and hire employees. And these economic forces are the same regardless of whether we're talking about a capitalist or socialist system. The economic system constrains how people may react to the laws of economics. It doesn't alter the laws of economics. So, what I'm about to say to you is not from any ideological perspective. It is simply what all economists understand given the state of the discipline.

The media enjoys portraying disagreement among economists about the minimum wage. Unfortunately, this gives the impression that economists aren't exactly sure how labor markets work. Economists do disagree about the effects of minimum wage hikes. However, virtually all of those disagreements involve details, such as who specifically is affected, to what extent they are affected, and how long the effects will persist. Economists' disagreements about the minimum wage are like disagreements as to how far Tom Brady can throw a pass, not disagreements as to whether he plays football. In a 2015 survey of 166 economists by the Employment Policies Institute on the effect of a $15 federal minimum wage, 83% said that a $15 minimum would reduce youth employment, 52% said that it would reduce adult employment, and 76% said that it would reduce the number of jobs available.[1]

I will proceed by giving you an economist's criticism of some of the common arguments for an increased minimum wage.

Claim: *The minimum wage requires employers to pay workers more.*
Reality: *The minimum wage prohibits workers from working.*

Proponents characterize a minimum wage as a control placed on employers. But it is actually a control placed on workers. The law prohibits a worker from working unless that worker can find someone willing to pay at least $7.25 an hour. Whether an employer is willing to pay the minimum wage depends on how much value the worker can contribute, and that depends on the worker's skills, experience, and education. If a worker is capable of adding $10 of value to a business every hour, then the worker's labor is worth $10 an hour. Requiring the employer to pay $12 an hour doesn't make the worker more valuable. It only makes him more expensive. And since no employer is going to pay $12 an hour for a worker who contributes $10 an hour in value, the employer will lay off the worker, leaving the worker with neither $12 an hour nor $10 an hour, but zero. Notice that this has nothing to do with whether the employer is greedy, whether the employer can afford the worker, or whether the wage is high enough to constitute a living wage. The question for the employer is extremely simple: Can the worker create enough value to offset the worker's wage? If the answer is no, then the worker's job disappears. My university is a good example. Several years ago, the university instituted a campus-wide minimum wage of $15 an hour. Within months of announcing the wage hike, the university

[1] https://www.epionline.org/studies/survey-of-us-economists-on-a-15-federal-minimum-wage/

replaced campus parking attendants with electronic access cards. Raising the minimum wage made the machines a cheaper alternative and so the parking attendants' jobs disappeared. The minimum wage hike didn't raise those workers to $15 an hour. It dropped them to zero.

Claim: *Raising the minimum wage puts more money in workers' pockets, and so stimulates the economy.*
Reality *Each additional dollar that lands in workers' pockets is exactly offset by one less dollar in customers', business owners', and unemployed workers' pockets.*

Proponents argue that increasing the minimum wage stimulates the economy by putting more money in workers' pockets. This argument ignores the fact that every additional dollar workers receive must come from one of three places: (1) customers, in the form of higher prices, (2) business owners in the form of reduced profits, or (3) other workers in the form of layoffs, reduced hours, or reduced benefits. Raising the minimum wage causes customers, business owners, and unemployed workers to spend less, and this exactly offsets the increased spending by workers who saw their wages rise.

Claim: *The minimum wage protects workers from employers who would pay them as little as possible.*
Reality *There is no law requiring employers to pay more than the minimum, yet 99% of jobs do pay more than the minimum. Competition and job skills are what buoy wages, not legislation.*

Proponents argue that the minimum wage prevents employers from paying pennies for labor. But if this were true, then all jobs would pay exactly the minimum wage because there is no law requiring employers to pay more. Yet, 99% of Pennsylvania workers earn more than the minimum wage.[2] The force preventing employers from paying workers as little as possible isn't

[2] https://www.workstats.dli.pa.gov/Documents/Minimum%20Wage%20Reports/Minimum%20Wage%20Report%202018.pdf

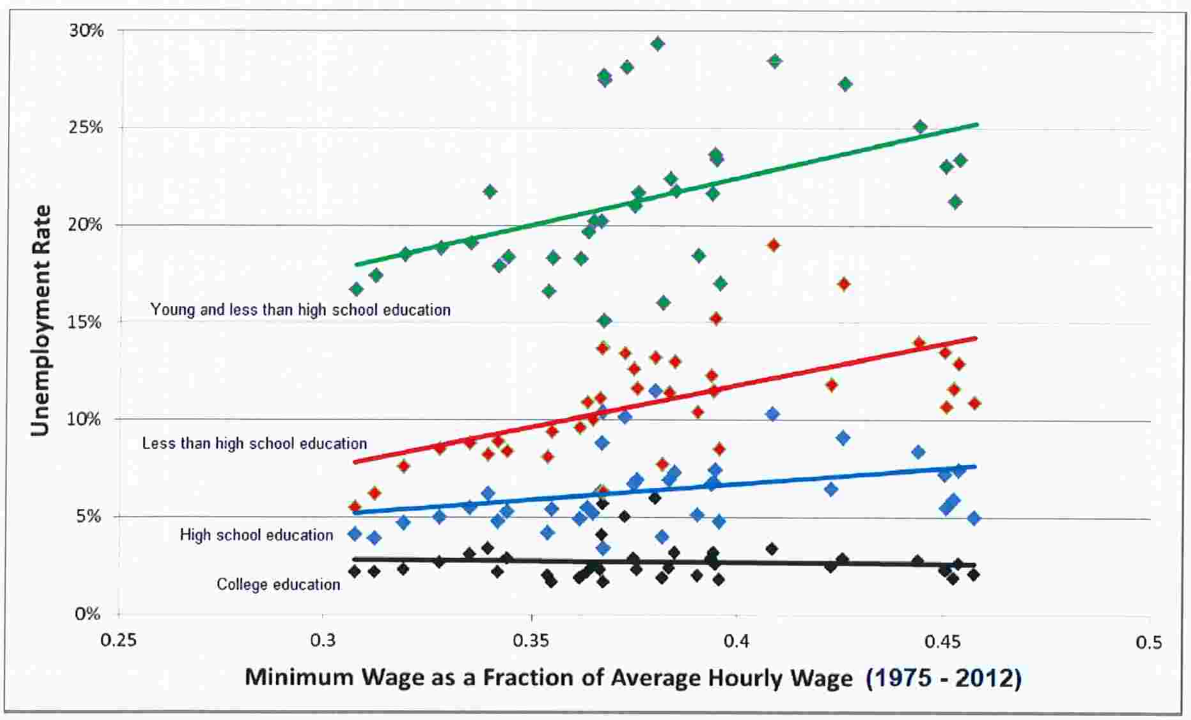
the minimum wage. That force is the value workers can contribute to a business. The more value a worker can contribute, the higher the pay the worker can command. This means that the key to increasing workers' wages is not legislating the wage rate but in helping workers to acquire skills, experience, and educations that will make their labor more valuable.

Claim: *Raising the minimum wage makes workers more productive.*
Reality *Raising the minimum wage increases average worker productivity by encouraging employers to lay off less productive workers.*

Proponents argue that increasing the wage rate makes workers more productive by making it more costly for workers to lose their jobs. Theory and evidence support this claim. But the claim itself is misleading. First, making workers more productive isn't necessarily beneficial. For example, if a 20% wage hike makes workers 10% more productive, then the additional productivity isn't worth the additional cost. But if a 20% wage hike makes workers 30% more productive, then not only is it worth the cost, but there's no need to mandate the wage hike because employers will voluntarily raise wages. Second, studies have shown that increasing the minimum wage does increase average worker productivity, but not because workers become more productive. Average productivity rises because the increased minimum wage gives employers added incentive to lay off less productive workers. Increasing the minimum wage increases average worker productivity in the same way that the outbreak of a deadly childhood disease increases the average age of the population. The disease doesn't make people live longer – it just kills off the young people.

Claim: *There is a lack of evidence that increasing the minimum wage increases unemployment.*
Reality *A minimum wage hike affects low-skilled labor differently from high-skilled labor. Studies that separate out low-skilled and high-skilled labor do find effects.*

Proponents argue that increasing the minimum wage doesn't increase unemployment. That depends on what we mean by, "unemployment." A minimum wage hike affects low-skilled labor differently from high-skilled labor. Looking at overall unemployment can mask the effects, making it appear that unemployment didn't rise. For example, raising the minimum wage to $12 should create unemployment among workers currently earning less than $12, but not among those earning more than $12. If we examine unemployment among low-skilled workers alone, we would see the effect. But if we examined unemployment among all workers, the effect may well be drowned out by the large number of workers who were not affected. The data below show the different effects minimum wage hikes have on unemployment among workers with different educations.



Data sources: Statistical Abstract of the United States, and Bureau of Labor Statistics

Conclusion

Don't confuse a minimum wage with a living wage.

The minimum wage is an entry-level wage. This is the wage we would expect someone with no jobs skills and no work experience to attain. It is unreasonable to expect that someone with no skills and no experience could earn a living wage. Indeed, more than half of minimum wage workers in Pennsylvania live in families with incomes exceeding $50,000, and more than 90% of Pennsylvania's minimum wage workers do not have dependents.[3] A minimum wage is the price of entering the workforce for the first time. The higher we set it, the harder we make it for workers to begin accruing job experience and skills that will make their labor more valuable in the future.

Once they enter the workforce, workers quickly earn more than the minimum wage.

In Pennsylvania, 9% of working 16-19 year olds earn the minimum wage. Five-percent of 20-24 year olds earn the minimum. One-percent of 25-34 year olds earn the minimum.[4] Seven-tenths of 1% of 35-44 year olds earn the minimum. Taking age as a proxy for experience, it is clear that as workers gain more experience, they cease to be minimum wage workers and become living wage workers. Raising the minimum wage delays their progress up the experience ladder by making it harder for them to find work.

---

[3] https://www.workstats.dli.pa.gov/Documents/Minimum%20Wage%20Reports/Minimum%20Wage%20Report%202018.pdf

[4] https://www.epionline.org/studies/survey-of-us-economists-on-a-15-federal-minimum-wage/

A $12 minimum wage will increase hourly labor costs by around 20%.

Excluding tipped workers, the average Pennsylvanian who earns less than $12 an hour earns around $10 an hour. If Pennsylvania raises the minimum wage to $12, experienced hourly workers who are earning more than $12 now will demand increases as well. Employers who do not accede will suffer significant morale problems. This means that a $12 minimum wage will likely raise hourly labor costs in Pennsylvania by around 20%.

The average US company has an 8% profit margin.[5] Businesses that employ large numbers of low-skilled workers often have profit margins closer to 2%. With such slim profit margins, a 20% rise in labor costs will get passed on to consumers in the form of higher prices and lesser-skilled workers in the form of layoffs. Raising prices forces workers to give back some of the gains of an increased wage. Laying off lesser-skilled workers harms the very people the minimum wage is intended to help.

---

[5] http://www.aei.org/publication/the-public-thinks-the-average-company-makes-a-36-profit-margin-which-is-about-5x-too-high-part-ii/