

What a Higher Minimum Wage Does for Workers and the Economy

By Peter Coy and Susan Berfield

Tom Wolfe himself couldn't have imagined a better New York juxtaposition. Pizza, Pepsi, and hot chicken wings were out on the table one November evening at Strive New York, an agency in East Harlem that helps ex-convicts and other chronically unemployed people get and keep jobs. Luz Droz, 32, who has a 10-month-old son, explained that she was trying to turn things around after "a little situation in my life," which turned out to be two prison sentences totaling eight years for dealing drugs and passing bad checks. She detests being on welfare but was turned down recently for a minimum-wage job at Burlington Coat Factory ([BURL](#)). "I thought I was going to get it," she said. "Once I get a job, I'm off to the races."

The same evening, one stop south on the 4 express subway line, waiters were serving hors d'oeuvres of tuna tartare and basil-slathered shrimp in the Upper East Side apartment of billionaire George Soros. The guest of honor was Soros's fellow billionaire David Sainsbury, the former chairman of the family-founded British supermarket chain J Sainsbury ([SBRY:LN](#)). He has a new book, *Progressive Capitalism*. Sainsbury will probably never meet Luz Droz, but he, too, had minimum-wage employment on his mind. To compete with China, he said, "the West must race to the top" and not try to "screw down the wages."

The down-on-her-luck mom who can't land a job at minimum pay and the billionaire who can't imagine paying so little are two voices in a global debate over not only the minimum wage, but also the bigger challenge of helping the least fortunate members of society. The federal minimum wage is \$7.25 an hour. President Obama called for a \$9 federal minimum by 2015 in his State of the Union address in February and then this fall endorsed a more ambitious bill, which is stuck in House and Senate committees, to raise it to \$10.10 by 2015. California, New York, Connecticut, Rhode Island, and New Jersey voted to raise state minimums this year. Last August fast-food workers in almost 60 cities struck or walked out in a bid for starting pay of \$15 an hour. In recent weeks two of the nation's largest private employers, Wal-Mart Stores ([WMT](#)) and McDonald's ([MCD](#)), have taken heat for paying many of their workers so little that they need government benefits and charity to get by.

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Raising the minimum wage is neither as wonderful as its advocates claim nor as dangerous as its detractors warn. On the upside, it would increase pay for millions of Americans, not only those earning the minimum but also those at fixed increments above it. These are people who could really use a raise. Contrary to what generations of students were taught in freshman econ, new research finds that minimum-wage increases at the state level have caused little, if any, harm to employment. "Outside of the simple Econ 101-type environment, increasing workers' pay can improve the functioning of the low-wage labor market," Arindrajit Dube, a University of Massachusetts economist, testified before Congress in March.

On the downside, a higher wage floor would undoubtedly price some marginal workers out of the market. Interns, for example, aren't allowed to work for less than the minimum while they learn the ropes. (They can be unpaid, but then they're not allowed to do real work.) A higher minimum wage would do nothing for the unemployed, among whom are the poorest of the poor. For them, other solutions are needed. "The search for a silver bullet is a mistake. We need lots of bullets," says Steven Pressman, an economist at New Jersey's Monmouth University.

Raising the wage to catch up with inflation invariably polls well, because most Americans perceive it as a matter of justice. Their hearts go out to the likes of Shawndraka Mack, 40, who works full time at \$7.60 an hour for a McDonald's in Charleston, S.C. She and her disabled fiancé are raising two teenagers in the trailer home she inherited from her mother. "I love what I do," she says, "but I don't want to work for nothing." Obama appealed to that sentiment in his State of the Union address when he said, "Tonight, let's declare that in the wealthiest nation on earth, no one who works full time should have to live in poverty." A Gallup poll in November found that 76 percent of Americans would vote for a \$9 federal wage floor.

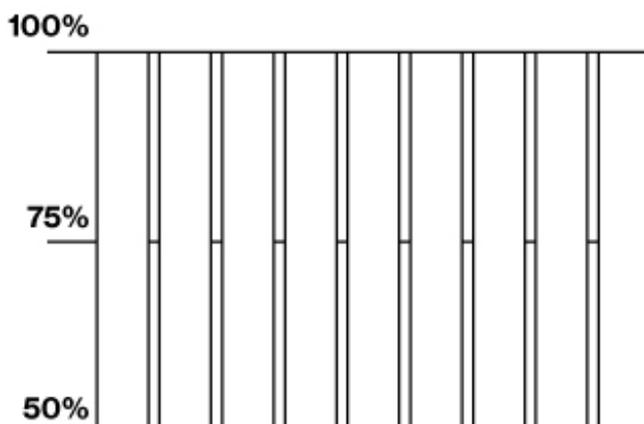
The public images of low-paying employers such as Wal-Mart and McDonald's take a hit during the holidays, when Americans are seized by a spirit of charity. Stephen Colbert mocked Wal-Mart after employees at one of its stores started a Thanksgiving food drive for fellow workers. "Now, some critics out there say Wal-Mart isn't doing enough, but they're wrong," Colbert said, "because Wal-Mart isn't doing anything."

Recognizing that they can't get on the wrong side of their customers, many of whom have below-average incomes, Wal-Mart and McDonald's are attempting to change the narrative. Both say they pay above the minimum to the vast majority of their employees. "Nationally, there has been an erosion of middle-class jobs, and we want to be part of the solution," David Tovar, Wal-Mart's vice president for communications, e-mailed journalists on Nov. 21. The same day in Chicago, McDonald's chief executive officer, Don Thompson, pointed out at Bloomberg's The Year Ahead: 2014 conference that 60 percent of the company's franchisees started in hourly jobs.

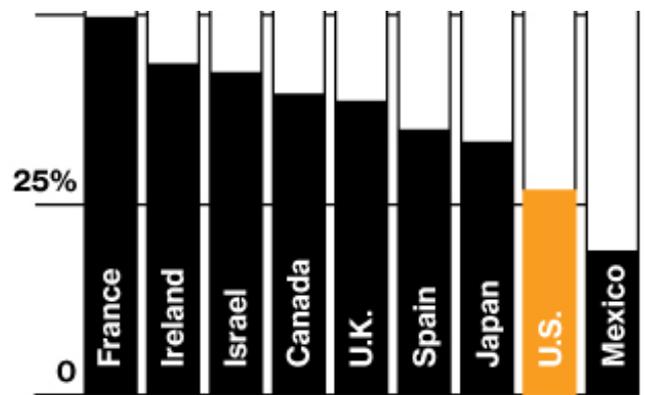
Ultimately, the case for higher minimum pay should be evaluated on its economic merits. "Wages are a market price—determined by supply and demand, the same as the price of apples or coal," one economist wrote in 1998. "The amorality of the market economy is part of its essence and cannot be legislated away." (That economist—surprise—was Paul Krugman, who was skeptical about living-wage ordinances but today says a healthy jump in the minimum wage is justified on economic grounds.)

The latest support is based on the economic theory of "search frictions," which won a Nobel Prize in 2010 for Peter Diamond, Dale Mortensen, and Christopher Pissarides. It's the idea that employers and job seekers don't find each other immediately. Fact: Some 3.9 million job openings went unfilled at the end of September, according to the Bureau of Labor Statistics. Raising the minimum wage makes workers less likely to quit, which reduces the number of openings at any given time, the theory goes. That boosts employment, offsetting layoffs of workers who are no longer worth their pay at the higher minimum. "There's a widespread recognition that we need models with search frictions to really understand the labor market," says Dube, the Massachusetts economist, who's part of a new generation of scholars studying the minimum wage.

The minimum wage as a percentage of the national average pay in 2012



America's minimum wage is 27 percent of the U.S. average pay, a lower ratio than that of any other member of the Organisation for Economic Co-operation and Development except Mexico. That doesn't prove that the U.S. floor is too low—only that it can be higher without the sky falling. In Denmark, among the leading countries in income equality and national happiness, the minimum pay set by negotiations between employer groups and unions is the equivalent of about \$20 an hour. Despite that, the World Bank has ranked Denmark as the easiest place in Europe to do business for three years running.



GRAPHIC BY BLOOMBERG BUSINESSWEEK
DATA: OECD

Still, raising the minimum wage is an inadequate response to the larger challenge of reducing poverty. “It’s just irrelevant to the real, first-order problems such families face,” writes John Cochrane, a University of Chicago economist. Brazil has a minimum wage, but it’s been far less effective in alleviating poverty than the renowned Bolsa Família program, which gives families cash payments as long as they get their children educated and vaccinated and meet other conditions, says **Marcelo Côrtes Neri, president of the Institute of Applied Economic Research in Brasília.**

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The deeper problem for today’s poor isn’t low pay. It’s that many have lost any connection to the world of work. In 1968, when the U.S. minimum wage hit its inflation-adjusted peak of \$10.70 an hour, 81 percent of men aged 20 and older had jobs. Now 67 percent do. In October the unemployment rate for black teenagers was 36 percent. “Raising the minimum wage is a short-term fix,” contends Wal-Mart’s Tovar. The long-term solution, he says, involves “expanding education, training, and workforce development.”

The minimum wage can never be more than a piece of the social safety net. It’s attractive to liberals because it doesn’t require getting a tax increase through Congress: The cost to society shows up instead in the prices that employers raise to cover their higher costs. Because it’s only for workers, however, it can’t possibly fill the void of inadequate food stamps, welfare, and housing assistance.

Photograph by Lucy Nicholson/Reuters A protest in Los Angeles on Nov. 7

In arguing for a higher minimum wage, Bloomberg View columnist Barry Ritholtz [recently blasted](#) Wal-Mart and McDonald’s as “welfare queens” because some of their employees, as a result of their meager pay, live partly on government benefits. (Families of McDonald’s workers have received an average \$1.2 billion a year in benefits, according to an academic study funded by Fast Food Forward, which helped organize the summer strikes.)



True, those hidden subsidies to employers would shrink if the minimum wage rose, but it’s unreasonable to think they would disappear entirely. Britain’s New Poor Law of 1834 tried to end subsidies to employers by preventing recipients of relief from working for them. It locked them up instead in poorhouses of Dickensian cruelty. That’s hardly an example to follow. The other way out of inadvertently subsidizing private employers would be to cut off benefits to anyone who got a job. But that would penalize people who landed work or induce them to stay unemployed.

Although a favorite of liberals, the notion of raising the minimum wage is in some ways deeply conservative. It's grounded in the traditional ethic that able-bodied people should support themselves by the sweat of their brows—and private employers, not the government, should be responsible for workers' livelihoods. But what if technology throws some people out of work not temporarily, but permanently? What if many service positions follow manufacturing jobs into obsolescence? (There's already a hamburger-making robot for sale.) If that happens, society will have to develop new ways to share its abundance with people whose services are no longer needed, speculates Brian Arthur, a nonresident professor at the Santa Fe Institute.

One up-and-coming solution is what advocates term unconditional basic income—an annual grant of fixed size that goes to every person in a country, rich or poor, regardless of whether they work or not. It's a big step away from the minimum wage. Milton Friedman, the late libertarian economist, favored a variant—a payment that would phase out at higher incomes—to replace the intrusiveness of the welfare state.

Europe is headquarters for the unconditional basic income movement. This fall petitioners managed to get it on the national ballot in Switzerland. (The date hasn't been set.) Giving people money unconditionally could start an epidemic of shirking work. But backers say most people would still want to work if they could, either to earn a standard of living above the spartan one guaranteed by the government, or to fulfill themselves, or both.

In the U.S., an increase in the minimum wage is far more likely than adoption of a universal basic income. A higher wage floor is right for low-skilled workers and harmless to the economy. But it's only one piece of a very large economic puzzle.

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