

Good for you, if you have a job (and keep it)

Why minimum wage increases are a costly way to make little progress

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19 January, 2012



AIMS is pleased to provide an opportunity for our next generation of thinkers to express their views to a public audience. Andreas Korfmann is a student in political science at the University of Toronto. His comments on the questionable good and demonstrable harm done by minimum wage legislation highlight some of the critical questions we need to ask in deciding where we should focus our collective efforts if we truly wish to eliminate poverty.

When reading an online issue of a Cape Breton Post article outlining the reaction to the minimum wage increases here in Nova Scotia last fall, I observed a comment posted by a reader who said “I like the wage increase as I am at a job which pays (minimum wage) and any increase is good for me”.

The reality is, this just isn’t so. Data from the past decade show that while there is little relation between unemployment and artificial wage floors—i.e. raising the minimum wage does not immediately result in job losses—there are hidden consequences in the form of higher prices, that ultimately lead to reduced living

standards. That’s hardly what proponents of higher minimum wages intend.

Minimum wage proponents argue that living costs are rising faster than wages, leaving the poor poorer. This is—again—a very valid concern, but does a rising minimum wage address it? Let’s look at inflation rates. They have been fairly low and since 2009, have been on steady decline—inflation levels for 2009 were as low as 0.3%. Conversely, minimum wage increases have been on a steady rise, and since 2004, have been greater than inflation—even reaching levels around 5 times as much—more than once. While there is no doubt that the economic downturn has contributed to the increases in the unemployment rate, studies of previous years’ data (see, for example, the work of Morley Gunderson cited below) show that there is a direct correlation between increased minimum wages and higher levels of unemployment, rendering the case for minimum wage regulation dubious.

Let’s look at the facts. With one exception,

every year since 2001, the national average rate of provincial minimum wages has risen. During this time, unemployment rates have also trended upward. Is that some sort of perverse correlation? Here's where things get tricky; some will point out—with good reason—that higher joblessness reflects overall economic deterioration rather than the impact of minimum wages. It is more likely, though, that while the recession may have been part of the problem, recent increases in those minimum wages are not entirely blameless in accelerating unemployment growth.

To answer the question why would increased wages result in higher unemployment, it is important to view this issue from the side of the employers—not just from the angle of workers or, for that matter, the politicians advocating these policies. So, let's say that you own a small burgers & fries restaurant—we'll call it "Wagey's"—and that you employ 6 minimum-wage employees (of which only 4 are working at the same time). Business is tough, especially with the big-chain "Burger Barn" restaurant located a block away. You then hear on the news that the government announced a scheduled minimum wage increase, and you start to worry, you're already paying your employees more than you can afford, and raising your prices is out of the question—that is, if you don't want to lose all your customers to the Burger Barn. Since you will now have to pay your employees more, and you cannot increase your prices, in order to stay in business there is only one real option: lay-off one worker (or two).

This scenario is a frequent reality when dealing with minimum wage legislation, and the statistics from the past decade show that it is not the big "Burger Barn" chains that suffer from minimum wage increases; it's the unskilled labour force and small businesses that suffer the most.

You may be asking yourselves "Why did he only mention fast food jobs? Surely there are other

sectors in which the minimum wage helps employees and employees?" Well, as much as I recognize the fact that advocates of minimum wage increases mean well, I have to say they're misguided. I used the example of a fast food restaurant because the reality is, out of the 5.8% of the total work-force earning minimum wage or less, the majority (about 60% according to Statistics Canada) of the total number of people working at this wage level are youth under the age of 25, and approximately 95% of youth under the age of 25 work for the food and services industry. It is also recorded by Statistics Canada that 86% of these youth live with their parents; so it makes sense to look here.

The data from the previous 10 years' labour force surveys show that there was not much of a connection between overall unemployment and the increase in minimum wage, but there were some subtle trends that are extremely important. There is a modest, but significant relationship between increases in minimum wages and the unemployment rate 2 to 3 years later. There were, with some exceptions, general increases in unemployment rates 3 years after a sharp increase in the minimum wage rate—and those rates have risen faster than ever over the past decade.

Initially these findings may not support specific conclusions, but there have been massive increases in government spending in order to prop-up the economy (especially so in the United States), reductions in interest rates and an increase in the amount of household debt. Those developments tend to obscure the underlying trends.

The reality is that minimum wages translate into the following choice: either raise your prices, or fire some workers. The alternative—to simply absorb the additional costs—would be bad business. This is where the issue of whether or not this has a direct link on unemployment and inflation comes to play; it most certainly affects

both of these economic indicators, but data from the past 10 years shows yet another hidden consequence from this sort of regulation. In recent years underlying economic conditions have shifted from mildly positive to deep recession and eventually tepid recovery. In this setting the relationship between minimum wage levels and unemployment has been somewhat obscured.

This does not mean, however, that they are not related—it simply means that there certainly are more factors at play. Let’s look at a 2006 study done by Morley Gunderson (AIMS research fellow and director of the Centre for Industrial Relations and Human Resources). It showed that between the years 1981-1997, data pointed to a relationship showing that unemployment almost always increased with the minimum wage—especially in youth ages 15-24.¹

A few simple ways to view the past decade would be to effectively recognize that there has been quite a bit of interference with the economy arising from stimulus spending. With interest rates hitting all-time lows, and little consequent impact on inflation, the past 10 years have been full of exceptions; so it hardly surprising that Statistics Canada’s numbers are evidencing some disconnect. But there is more at play here. When examining business trends before, during and after raises in minimum wages in industries where the majority of minimum wage workers earn a living (food & service sector), connections can be drawn linking the slight increases in cost (paying increased wages), to the slight increase in prices. This is done at such a small scale that it has a minimal affect on inflation levels, and will go mainly unnoticed. This poses a problem. The problem being that larger chains and companies dominate minimum wage industries, and with oligopolistic-style competition already in play, a universal increase in cost (minimum wage hike) will result in an across the board cost increase. This is why some proponents of the minimum wage have argued after surveying fast-food

employers that it does not affect employment negatively at all. Well there is a hole in this theory, and a serious one at that.

Why do companies compete? The answer should be clear; to gain the upper edge on competition in order to stay in business. This means lowering prices to draw-in more customers. When very large, well-established chains are forced to pay their employees slightly more, they will. They have to. With pay increases, they will then begin hiring freezes, stopping future employment and reducing hours of current employees. The only way they can keep on their current level of employees, (which is usually the case, because companies in the fast-food industry—for example—already hire the minimum possible number of employees) would be to slightly increase their prices.

All this may not seem like such a big issue, who cares if we have to pay an extra 25 cents for a burger and fries?

If only it were that simple. There are (believe it or not) other participants in the food and service industry. Small businesses and individual entrepreneurs—like our “Wagey’s” restaurant, already face greater barriers to entry (initial operating costs when entering the market), let alone having nowhere near the level of resources that larger companies have access to. As was mentioned before, it becomes more difficult for the independent, small business to compete with the big guys, and eventually they will no longer be able to sustain themselves and will be forced to close their doors. The larger chains do not have to worry about this happening to them simply because they were around before significant minimum wage levels existed, and they do not have to worry about competition because they already have the same restrictions as their other large-scale counterparts.

The sad reality is, the “let’s stick up for the little guy” minimum wage legislation actually works

against the very people it seeks to benefit. With less competition and new business, there will be a decrease in customer service, less innovation, higher prices, and in the long run; fewer jobs.

So why don't people do something about this? Simple; less than 6 percent of all employees in Canada earn minimum wage or less, and more than half of that figure consists of youth ages 15-24. Not enough people who matter to politicians and bureaucrats occupy these jobs.

Youth (ages 15-24) make up the largest portion of the “workforce” earning minimum wage or less (just under 60%), out of this portion, roughly 95% work in the food and services sector, which is dominated by large-scale chains and corporations. This means that the minimum wage floor that is intended “to reduce the number of children living in poverty by 25 per cent over five years... boosting benefits for low-income families” (according to the Government of Ontario’s website- where the minimum wage has increased by almost “50 per cent since 2004, when it stood at \$6.85”), will actually do the opposite. These are very lofty goals, but are all proven to do the opposite—in fact only about 5-6% of the “workforce” earns minimum wage- of which most are youth, not “low-income families”.

Canada represents a good test tube to measure the effects of minimum wage legislation on unemployment, since in the United States, the minimum wage is set on a federal basis and in Canada it is the responsibility of the provincial governments. This makes it easier for economists to compare the labour market reactions in a province that increased the minimum wage with one that didn't. Generally speaking, findings have shown a consistent link between unemployment and minimum wage increases. Upon discovering the irregularities in the previous decade's labour statistics, previous years' findings were examined, including those for the United States and results tended to show

a correlation; for example, in Massachusetts, youth employment rates dropped by one-third after the minimum wage rose by 88% between the years 1995 and 2008.

It can be noted, however that there have been studies completed that argue that the minimum wage increases do not affect unemployment, if not actually decrease it all together. The major one would be one done in 1992 by David Card and Alan Krueger², where they surveyed employers in the food & service sector both before and after an 18% hike in minimum wage in the state of New Jersey. Their results showed that the overall number of employers that they surveyed actually hired more workers. This may seem like an overwhelmingly case of proving economic theory wrong; however they only surveyed a set of those large-scale fast-food types of businesses that would not really be affected by these increases.

Their inputs only allowed for over-all employment stats, and did not account for the increase in part-time employment; as more workers apply to these jobs when wages increase, and costs go up for the employers, they reduce hours of full-time employees and hire more part timers instead- it's just cheaper for them to do so (less benefits, no over-time pay etc.). This study also only examines short-term employment trends- and as concluded earlier-they are harder to notice, especially when we do not count the majority of youth and institutionalized persons in our data.

At a time when unions are striking because their wages “haven't increased at the rate of other public sector salaries & the minimum wage”, and with unemployment becoming the next big topic in American politics, we should really pay more attention to the outcomes of imposing price & wage floors (and ceilings for that matter) on our economy.

With all of the hidden costs to minimum wage

legislation, the question arises whether or not it really helps those it is intended to. We all want to live comfortably, in a society where others do not have to witness unnecessary hardship. But the method of achieving this has been far from realized. With studies concluding that a 10% increase in the minimum wage is likely to decrease unemployment by an average of 3-6% for youth aged 15-25³, while others point in the opposite direction, topped off by official government statistics leaving out significant chunks of the working population, it is hard to say what direction we should take. But there is a very clear pattern here. What we've been doing thus far has not seemed to alleviate the amount of poverty and hardship that we have set out to do. Perhaps it is time we explored other ways of dealing with this issue—especially in a time when private sector growth is slow and unemployment is high.



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¹ Morley Gunderson; “*Minimum Wages: Operating with a blunt instrument*” Atlantic Institute for Market Studies; Dec 2008
<http://www.aims.ca/site/media/aims/LabourSeries1.pdf>

² See for example: *Myth and Measurement: The New Economics of the Minimum Wage*
David Card & Alan B. Krueger

³ Godin, Keith, and Niels Veldhuis. *The Economic Effects of Increasing British Columbia’s Minimum Wage. Studies in Labour Markets*. Fraser Institute. 2009