NATIONAL REVIEW

More than the Minimum Wage

Conservatives should help the poor with wage subsidies, not price floors.

By Michael R. Strain — December 11, 2013

Minimum-wage fever is gripping the nation — again. President Obama proposed an increase in the minimum wage from its current level, $7.25 per hour, to $9 per hour in his 2013 State of the Union address, and in his December 4 speech on economic mobility he pledged "to keep pushing until we get a higher minimum wage for hard-working Americans across the entire country."

The president supports the bill sponsored by Senator Tom Harkin of Iowa and Representative George Miller of California, Democrats both, to raise the federal minimum wage to $10.10 per hour. The day after the president's recent speech, striking fast-food workers in over 100 cities across the country protested their low wages, demanding an increase in the minimum wage to $15 per hour.

It is easy to understand the frustration of (some of) these workers. Conservatives should not be glib about the fact that $7.25 per hour may buy you the bootstraps you'll need to pull yourself up, but not much more. Average hourly wages of workers in the retail and leisure-and-hospitality industries have had a rough 5 or 10 years.

And there is a widespread feeling throughout the country that, since the Great Recession, financiers on Wall Street have done well and the top 1 percent of earners have done great while hard-working families have been left with stagnant wages, higher tuition, and more expensive health care. It's no surprise, then, that a Gallup poll conducted last month found that 76 percent of respondents would vote to increase the minimum wage to $9 per hour.

Perhaps there's wisdom in crowds, but not this time. Those 76 percent of Americans are wrong. Conservatives should definitely support government action to help the working poor, but increasing the minimum wage isn't the answer.

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Research published in 2010 by economists Joseph J. Sabia and Richard V. Burkhauser found that minimum-wage increases (state and federal) between 2003 and 2007 "had no effect on state poverty rates." They found that only 11 percent of workers who would gain from raising the federal minimum wage from $7.25 to $9.50 per hour live in poor households, while 42 percent live in households with incomes 3 times the poverty line or more — considerably above America's median household income. Only about 1 in 4 workers who would be affected by increasing the minimum wage to $9 per hour are in families making less than $20,000 per year, according to the left-leaning Economic Policy Institute.

How can giving a raise to minimum-wage workers help so many higher-income households? After all, if you earn the federal minimum wage and work full-time, you're bringing in less than $15,000 per year. But many minimum-wage workers are young, and they are usually not the primary breadwinner in their family. Although teenagers make up only 5.4 percent of workers who are paid hourly wages, they are 24.1 percent of minimum-wage workers. Less than 3 percent of hourly-wage earners over the age of 24 earn at or below the federal minimum.

Many on the right argue that increasing the minimum wage is bad policy because it would kill jobs by decreasing the number available to low-skill workers. It's natural to expect economists to confirm or deny this. But, in this case as in many, economists disappoint by answering: Honestly, we don't know.

The 101-level theory is clear. When a wage floor above the market wage is instituted, firms will want to hire fewer workers. In addition, more people will want to become workers because the wage they will earn from working has gone up. The combination of firms wanting fewer workers and more people wanting to work increases unemployment.

Increasing the minimum wage lowers the cost of investing in a machine relative to employing a low-skill worker. Applebee's intends to put tablet computers at every table to facilitate food and drink ordering. Customers at fast-food restaurants often serve themselves their own drinks through dispensers. At grocery stores and pharmacies it is now common for customers to pay for their items at self-checkout machines. Why is this happening? Because investing in tablets, drink dispensers, and self-checkout machines is cheaper than employing human beings. And part of the reason human beings are relatively expensive is because of the minimum wage.

Do the data back this logic up? Is there evidence that raising the minimum wage lowers employment?

The old consensus was that a 10 percent increase in the minimum wage would lower low-skill employment by between 1 and 3 percent. There are currently 4.5 million teenagers working in the United States. If we increased the federal minimum to $10.10 per hour — a 39 percent increase — then the old estimates suggest that teen employment would drop by between 4 and 12 percent. In levels, that's a loss of around 175,000 to 525,000 jobs. That ain't nothing. A little under 10 million high-school dropouts over the age of 24 currently have jobs. The old estimates suggest that a good chunk of these jobs could go, too.

But are the old estimates correct? For the past 20 years or so economists have studied minimum-wage increases using new statistical methods, and many — through certainly not all — of the more prominent studies show that raising the minimum wage does not lower employment. How could that be? Businesses could pass the cost of the increase on to their customers in the form of higher prices. (Though that would not benefit the low-skill workers who shop at businesses that heavily employee minimum-wage workers.) Or workers could work harder and would be less likely to quit because they like getting paid more, increasing the firm's profits and allowing the firm to keep employment at pre-increase levels.

That said, despite the newer estimates, many economists continue to believe that raising the minimum wage lowers employment. The University of Chicago Booth School of Business polled some top academic economists in February and asked them whether "raising the federal minimum wage to $9 per hour would make it noticeably harder for low-skill workers to find employment." Thirty-four percent agreed, 32 percent disagreed, and 24 percent were uncertain. I am a credentialed economist, and based on my reading of the evidence I would have been in the one-third who agreed.

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But an important reality that gets lost in translating the academic literature into the public debate is that no one argues that raising the minimum wage will increase employment.

And today, shouldn't that be the point?

The labor market for young and low-skill workers is in terrible shape. More than 14 percent of workers aged 16–24 are unemployed. The situation is even worse if you look only at teenagers, over 1 in 5 of whom are unemployed. The unemployment rate for high-school dropouts over the age of 24 is 10.8 percent — a two-decade high — and only 4 people out of every 10 in that group have jobs. And there are still a staggering 4.1 million unemployed workers who have been looking for a job for six months or longer, many of whom are young or low-skill.

Hundreds of thousands of low-skill workers are trying to find a job but can't. Is it really the right time to raise the cost of hiring and make it harder for businesses to hire them? Some studies say a higher minimum wage will lower employment; some say employment will remain unchanged. Shouldn't we err on the side of caution?

Young workers need to get their start in life. Many young workers will use their first job to gain invaluable experience — learning for the first time how to deal with a boss, coworkers, and customers; developing professional skills like punctuality, respect for authority, and courtesy; simply learning how to be a worker.

Society owes these unemployed young and low-skill workers the best shot it can give them at earning their own success in the labor market. Government should not place an obstacle in their paths. Especially with a low-skill labor market as bad as ours, the minimum wage would be exactly that.

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Many conservatives will be tempted to leave it there. But just as society should not erect barriers in the paths of young and low-skill workers, so too should it be helping to support the working poor — the stated goal of minimum-wage advocates — and to bring more people into the workforce. Households headed by a full-time worker should not live in poverty. Conservatives, who champion work and earned success, should be the first to agree that more can be done to encourage these goals.

They have a very simple option: Expand the Earned-Income Tax Credit.

The EITC is a federal income-transfer program — structured as a refundable tax credit — for working-class families. It rewards work by supplementing earned income. For a single worker with two children in 2013, the EITC paid 40 cents for every dollar of earned income up to $13,430, providing a maximum subsidy of $5,372. (The subsidy phases out as income rises above a certain level to ensure that higher-income households are not eligible.)

The credit is a very effective anti-poverty tool because it supplements earnings *and* incentivizes employment. Expansions of the EITC have been very successful at encouraging work, particularly among single mothers during the 1990s. The Tax Policy Center estimates that nearly 26 million households will receive $60 billion from the EITC in 2013. The IRS estimates that in 2009 nearly 7 million people — including over 3 million children — were lifted out of poverty by the EITC.

It's a more effective anti-poverty tool than the minimum wage because it is targeted at working-class households. Households that earn above a maximum amount do not qualify for the subsidy. The minimum wage, in contrast, is uninterested in the household income of the minimum-wage worker. A millionaire's 16-year-old daughter qualifies, despite her family's wealth.

Despite its obvious appeal, the EITC has some shortcomings. It can impose significant marriage penalties, and it gives very little help to childless workers. It is also true that the IRS makes a troublingly large share of improper EITC payments, most likely due to the complexity of the EITC's rules.

These problems can be fixed, of course, and are not a good enough reason to oppose expanding the EITC to help the working poor. The program could be amended easily to offer more support to childless workers and to mitigate the marriage penalties. And IRS errors should not stand in the way of attempting to ensure that no American who works full-time and heads a household lives in poverty.

The EITC could also easily be supplemented with a more straightforward wage subsidy — to full-time head-of-household workers who work a minimum number of hours per week, for instance, and, say, earned a low enough amount in the previous year. If you earn $7.25 per hour, for every hour you work the government would cut you a check for 3 bucks. Easy as pie. Around 1.8 million hourly-wage workers over the age of 24 earned at or below the federal minimum wage in 2012. Let's take the most generous case and assume that all of them worked full-time and lived in working-class households. With a wage subsidy of $3 per hour, we're talking an annual federal expenditure of $11 billion.

Many conservatives will argue that given terrifying long-run debt projections, now is not the time to add billions of dollars per year to federal outlays. This prudence is commendable, but outlays and revenue are not immovable objects. Conservatives should couple an EITC expansion or direct wage subsidy with a reduction in other tax expenditures: the $70 billion in federal spending on the mortgage-interest deduction, say, or the $77 billion deduction for state and local taxes.

Gains from the mortgage-interest and state- and local-tax deductions are overwhelmingly enjoyed by the top 20 percent of households by income. Government assistance should be directed at those who need it most, and modest curtailments of these tax expenditures could provide more than enough revenue to supplement the earnings of the working poor.

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But is that really the government's job?

Liberals have argued that programs like the EITC represent a subsidy from government to business. Despite their large profits, the liberal logic goes, businesses are choosing not to pay their workers enough money to escape poverty, forcing government to provide things like the EITC and food stamps. These provisions subsidize businesses that “should” be paying “living wages” and allow them “to get away with” paying less.

This misunderstands how wages work. If a low-skill worker can only contribute $7 per hour in revenue to a firm, then the firm will not employ the worker at $10 per hour. If it did, the firm would lose three bucks for every hour the worker was on the job. We can sentimentalize businesses all we want, but they simply aren’t going to pay workers more than they’re worth.

The argument is also wrong on a deeper level. Liberals, in supporting minimum-wage increases, implicitly argue that the employers of low-skill workers, together with consumers of the products and services the workers help provide, should bear the burden of ensuring that low-skill workers don’t live in poverty. Conservatives should reject this argument, insisting that all of society is responsible for helping the working poor — to escape poverty, to earn their own success, to flourish.

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