

# WebMemo



Published by The Heritage Foundation

No. 1385  
March 8, 2007

## A Higher Minimum Wage Equals Less Economic Freedom

*Tim Kane, Ph.D., and Anthony B. Kim*

The U.S. Congress recently voted to increase the federal minimum wage from \$5.15 to \$7.25 over a two-year period—a dramatic 40 percent increase. Final action on the minimum wage increase has not yet been cleared due to differences in the Senate bill and the House bill. Congress should be reminded that a minimum wage is nothing more than a price control on labor, which is a restriction on economic freedom. Any nation that raises its minimum wage compromises its economic freedom score, as reflected in the *Index of Economic Freedom*. The proposed change could reduce America's labor freedom score in the *Index* from 92 percent to 87 percent. America, now the fourth freest economy in the world, would drop to sixth place due to this single policy change.

**Minimum Wage in the Labor Market.** In a free market economy, prices allocate land, information, capital goods, and labor to their highest use. Markets are truly free only if prices are free. For example, a firm that needs more workers signals its need to the labor market by offering a higher wage. Wages are good indicators that direct people to employment and show businesses how to expand. Freely floating prices allocate resources efficiently to places where they will take root and boost economic productivity.

Many types of labor regulations infringe on this market mechanism by disturbing price signals and, therefore, restraining the economic freedom of business owners and workers. One of the most prominent is the minimum wage. By setting a government-

specified floor for workers' wages, minimum wage laws tend to disrupt labor supply and demand.

The labor market is not excused from the basic economic principle that artificially high prices cause lower demand. In particular, less skilled workers will suffer. The mismatch between labor supply and labor demand is likely to harm the very people the minimum wage is intended to help. A recent National Bureau of Economic Research study reviewed about 90 empirical papers from the early 1990s to the present. It found that two-thirds of those papers conclude that the effects of the minimum wage are negative. Further, among the most methodologically rigorous of those papers, "almost all point to negative employment effects." More specifically, the study also revealed that there is "relatively overwhelming evidence of stronger disemployment" impacts on less experienced workers.<sup>1</sup>

**Labor Freedom and Minimum Wage.** Of even greater concern, increasing minimum wage is likely to curtail one of the pillars of U.S. international competitiveness, labor freedom. Labor freedom, like property rights and business freedom, is fundamental to a country's overall economic freedom as measured by the *Index of Economic Freedom*, an annual study by The Heritage Foundation and *The Wall*

This paper, in its entirety, can be found at:  
[www.heritage.org/research/labor/wm1385.cfm](http://www.heritage.org/research/labor/wm1385.cfm)

Produced by the Center for International  
Trade and Economics (CITE)

Published by The Heritage Foundation  
214 Massachusetts Avenue, NE  
Washington, DC 20002-4999  
(202) 546-4400 • [heritage.org](http://heritage.org)

Nothing written here is to be construed as necessarily reflecting the views of The Heritage Foundation or as an attempt to aid or hinder the passage of any bill before Congress.

*Street Journal*. The *Index* grades 157 countries' economic freedom, and one of the *Index's* ten key components is a labor freedom factor that measures the ability of workers and businesses to interact without restrictions imposed by the government.<sup>2</sup>

According to the 2007 *Index*, U.S. labor markets are 92.1 percent free. Raising the minimum wage, which is one of the four elements of the labor freedom factor, will lower the score for U.S. labor freedom. The amount of the drop depends on how the 50 states react, because many have higher local minimum wages and would presumably raise theirs in response to congressional action. The proposed increase in the federal minimum wage is estimated to reduce the overall U.S. labor freedom score by 1.2 to 4.8 percentage points, dropping the labor score potentially as low as 87.3 percent.<sup>3</sup>

America's economy is currently rated as 82 percent free overall. The implications of the 40 percent

increase in the minimum wage could drop that score to 81.5 percent free.

**Conclusion.** Supporters of increasing the minimum wage argue that they do so in order to help poor and less skilled workers. But government intrusion into the labor market through raising minimum wage generates the same problems that similar interventions produce in other markets. The minimum wage disrupts the natural interaction of supply and demand and leads to inefficient allocations of labor and, eventually, increased unemployment. Congress should reconsider increasing the minimum wage and look for ways to help American workers by increasing their competitiveness.

—Tim Kane, Ph.D., is Director of, and Anthony B. Kim is Policy Analyst in, the Center for International Trade and Economics at The Heritage Foundation.

1. David Neumark and William Wascher, "Minimum Wages and Employment: A Review of Evidence from the New Minimum Wage Research," NBER *Working Paper* No. 12663, November 2006, at [www.nber.org/papers/W12663](http://www.nber.org/papers/W12663) (March 6, 2007).
2. The following four quantitative components each account for 25 percent of the labor freedom factor: minimum wage, rigidity of hours, difficulty of firing redundant employees, and cost of firing redundant workers. For more information on the labor factor, see Tim Kane, Ph.D., Kim R. Holmes, Ph.D., and Mary Anastasia O'Grady, *2007 Index of Economic Freedom* (Washington, D.C.: Heritage Books and Dow Jones & Company, Inc.), chapter 3, at [www.heritage.org/research/features/index/chapters/htm/index2007\\_chap3.cfm](http://www.heritage.org/research/features/index/chapters/htm/index2007_chap3.cfm).
3. This assumes that all variables in the labor freedom factor other than the minimum wage rate remain constant.