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# THE MINIMUM WAGE: RESTRICTING JOBS FOR YOUTH

## INTRODUCTION

In January 1980, Ronald Reagan declared: "The minimum wage has caused more misery and unemployment than anything since the Great Depression."[1] This observation is particularly true regarding teenagers and minorities. Several bills currently before Congress would limit the harmful effects of the minimum wage on youth unemployment by establishing a "subminimum" wage rate for teenagers, and would thereby create financial incentives for firms to hire young, unskilled workers. A similar proposal was narrowly defeated (by one vote) in the House of Representatives in 1977.

To review the social, political, and economic consequences of the minimum wage, Congress created the Minimum Wage Study Commission in 1977. In its recently issued report, the Commission recommended against enacting a youth differential. This is surprising in light of the vast evidence presented before the Commission as to the damage done by the minimum wage. As Commissioner S. Warne Robinson points out in his minority report:

> The Commission majority's near-total disregard for facts became apparent as the results of our economic research began taking shape. With the overwhelming bulk of the evidence from these studies showing that the minimum wage hurts far more poor families than it helps, the majority proclaimed the view that Congress did not really expect the Commission to base its recommendations on the facts anyway. When the evidence became inescapable that a rising minimum wage wipes out

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1 "A Balky Assault on Minimum Wages," Newsweek, March 30, 1981, p. 75.

> millions of job opportunities for young people, women, the elderly, and the disadvantaged, the Commission's majority did not even bother to refute the facts. They were simply declared immaterial.[2]

Continuing high unemployment rates, however, mandate an objective re-evaluation of this timely and necessary proposal.

## BACKGROUND

The federal minimum wage was first established as part of the Fair Labor Standards Act in 1938 at 25 cents an hour. Many workers were not covered by the initial Act, most notably those in the retail trade and service industries. The original Act has been amended six times to expand coverage and provide adjustments to compensate for inflation. Both the minimum wage (in real terms) and the percentage of workers in covered employment have roughly doubled since 1938. Table 1 provides minimum wage values (in nominal and real terms) for each of the years the minimum was raised and the estimated coverage for the private non-agricultural sector. These figures, however, probably understate the true magnitude of the legislated changes. First, the value of the minimum wage is raised by costs to the employer, such as social security and unemployment insurance contributions, which have increased substantially over the years. Second, the workers originally covered were disproportionately in high wage industries, mitigating the initial adverse impact of coverage. Subsequent amendments extended coverage to workers in disproportionately low wage employment, thus magnifying the effects of coverage. These points are important because they help explain the correlation between minimum wage legislation and high unemployment rates among certain demographic groups such as teenagers and minorities.

## YOUTH DIFFERENTIAL

Senator Orrin Hatch (R-Utah), Chairman of the Senate Labor and Human Resources Committee, has introduced the Youth Opportunity Wage Act of 1981 (S. 348), which would encourage youth employment by providing a lower minimum wage for teenage workers. Under this bill, employers would be allowed to pay 75 percent of the minimum wage to any youth under 20 years of age for a period of six months, at which time the employer would be required to pay at least the full minimum wage. Employers would be penalized for any one of the following violations under the Act: 1) employing a youth at less than 75 percent of the minimum wage; 2) paying a reduced wage for more than six months; 3) substituting youth labor at less than the minimum wage for adult labor; and 4)

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2 "Minority Report of Commissioner S. Warne Robinson," in Report of the Minimum Wage Study Commission, Vol. 1, May 1981, pp. 184-85.

TABLE 1

The Basic Minimum Wage and Aggregate Coverage, 1938-1981

| Month/Year of Change in Minimum | Minimum Wage | | Percentage of All Nonsupervisory Employees in Private, Nonagricultural Work covered |
|---|---|---|---|
| | Current Dollars | Constant 1938 Dollars | |
| 10/38 | $0.25 | $0.25 | 43.4 |
| 10/39 | 0.30 | 0.30 | 47.1 |
| 10/45 | 0.40 | 0.31 | 55.4 |
| 1/50 | 0.75 | 0.45 | 53.4 |
| 3/56 | 1.00 | 0.52 | 53.1 |
| 9/61 | 1.15 | 0.54 | 62.1 |
| 9/63 | 1.25 | 0.57 | 62.1 |
| 2/67 | 1.40 | 0.60 | 75.3 |
| 2/68 | 1.60 | 0.66 | 72.6 |
| 5/74 | 2.00 | 0.58 | 83.7 |
| 1/75 | 2.10 | 0.57 | 83.3 |
| 1/76 | 2.30 | 0.58 | 83.0 |
| 1/78 | 2.65 | 0.59 | 83.8 |
| 1/79 | 2.90 | 0.59 | 83.8 |
| 1/80 | 3.10 | 0.56 | 83.8 |
| 1/81 | 3.35 | 0.57 | 83.8 |

Sources: Finis Welch, Minimum Wages: Issues and Evidence (Washington, D.C.: American Enterprise Institute, 1978), p. 3; and James W. Singer, "A Subminimum Wage--Jobs for Youths or a Break for Their Employers?" National Journal, January 24, 1981, p. 146.

hiring new young employees to replace existing youths to gain continual advantage of the youth differential.

Senator Charles Percy (R-Ill.) has proposed a similar bill (S. 430), but has raised the youth subminimum somewhat, to 85 percent of the full minimum wage, while Senator Don Nickles' (R-Okla.) bill (S. 658) would exempt employees under the age of 18 from the minimum wage provisions (Section 6) of the Fair Labor Standards Act.

## THE MINIMUM WAGE AND EMPLOYMENT THEORY

A basic law of economics is that the quantity of labor demanded is inversely related to the wage rate. When a minimum wage is established at a level above one that would be determined by market forces, employment opportunities are restricted for the least productive workers by pricing their services out of the market. The resulting higher labor costs may exceed the value of some workers' services, causing disemployment among these workers.

The minimum wage alters the relative prices of labor and other inputs by making low-skilled labor relatively more expensive and inducing a substitution towards other inputs such as capital and higher wage labor, thereby resulting in an inefficient allocation of resources. Moreover, increased production costs would reduce output and lower the demand for all inputs. Government intervention in the labor market via minimum wage legislation may have some far-reaching effects, such as forcing some firms to close and others to shift into new industries. Again, this is suboptimal from an efficiency standpoint.

The minimum wage may benefit those workers who retain their jobs at the higher wage, but those who lose their jobs or are not hired at all clearly are made worse off. Some unemployed workers may seek jobs in uncovered sectors, where minimum wage laws pose no barriers to employment, but in so doing, increase the supply of labor, exerting downward pressure on wage rates in those areas. In addition, as coverage has expanded, fewer jobs have become available in uncovered sectors for displaced workers to turn to.

ON-THE-JOB TRAINING

The minimum wage discriminates against the most disadvantaged workers by denying them an opportunity to develop skills and gain experience through on-the-job training because it makes it unprofitable for employers to hire unskilled and young workers. To illustrate, a distinction must be drawn between a worker's "observed" wage and his "full" wage. In addition to a money wage, the "full" wage includes non-monetary rewards from works such as fringe benefits and on-the-job training. Employers are willing to supply these non-pecuniary benefits because the workers are willing to pay for them with reduced wages. Many workers accept a low wage initially, in return for training, because they view it as an investment in human capital that will enable them to command greater earnings in the future. Such training is especially important for young workers because it provides them with a chance to learn skills and develop productive work habits. A higher minimum wage mandating employers to raise their monetary wage may result in reduced fringe benefits and training opportunities. Hence, even those workers who keep their jobs may be worse off than before. This would be especially true if employee training were drastically curtailed because of its potentially powerful effect on future compensation. Martin Feldstein asserts that the minimum wage may actually lower the lifetime earnings for many workers:

> the minimum wage law has an unambiguously harmful effect on some young workers. Even if an individual were willing to "buy" on-the-job training by taking a very low wage for six months or a year, the minimum wage law would not permit him to do so....For the disadvantaged, the minimum wage law may have the ironic

> effect of lowering lifetime incomes by a very large amount.[3]

Consequently, the minimum wage often hurts the very group it was designed to help. Milton Friedman has a similar view: "The real tragedy of minimum wage laws is that they are supported by well-meaning groups who want to reduce poverty. But the people who are hurt most by higher minimums are the most poverty stricken."[4]

A special youth subminimum would ameliorate the pernicious effects of the minimum wage on youth unemployment. Walter Williams, a visiting professor of economics at George Mason University and an Adjunct Scholar at The Heritage Foundation, makes the following point: "A youth subminimum would take into account that young workers are generally less productive than adults and would eliminate discrimination against low-skilled teenagers."[5] Employers would have an incentive to hire and train unemployed youth because the reduced labor costs would make it more profitable for firms to hire labor and expand output. The employment effects would also help deter many teenagers from falling victim to a life of crime or indolence.

## DISCRIMINATION

The minimum wage has had an especially devastating impact on black teenage employment. In 1948, the overall unemployment rate was 3.8 percent and about 10 percent for teenagers, both black and white. This difference is not unusual given the inexperience of a group entering the labor market for the first time. At that time, the minimum wage (in real terms) and the percentage of the workforce covered were relatively low. Periodic adjustments raising the minimum and expanding coverage have been accompanied by concomitant increases in the youth unemployment rate, especially among blacks. This can be seen from the results in Table 2. During April of 1981, youth unemployment among white male teenagers aged 16 to 19 was 16.5 percent, while the corresponding figure for blacks was 37.3 percent. This gap has arisen because the minimum wage makes it costless for an employer to discriminate.

> The minimum wage gives firms effective economic incentive to seek to hire only the most productive employees, which means that firms are less willing to hire and/or train the least productive employee which includes

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3 Martin Feldstein, "The Economics of the New Unemployment," Public Interest, Vol. 33 (Fall 1973), p. 15.

4 Milton Friedman, "The Minimum Wage Rate, Who Really Pays?" An Interview with Milton Friedman and Yale Brozen (Free Society Association ed., 1966), pp. 26-7.

5 James W. Singer, "A Subminimum Wage -- Jobs for Youths or a Break for Their Employers?," National Journal, January 24, 1981, p. 147.

teenagers and particularly minority teenagers. By holding all else constant, such as worker productivity, the minimum wage law gives firms incentive to indulge whatever racial preferences that they may hold.[6]

TABLE 2

Comparison of Youth and General Unemployment by Race (Males)

| Year | General | White 16-17 | Black 16-17 | B/W Ratio | White 18-19 | Black 18-19 | B/W Ratio |
|---|---|---|---|---|---|---|---|
| 1948 | 3.8 | 10.2 | 9.4 | .92 | 9.6 | 10.5 | 1.11 |
| 1949 | 5.9 | 13.4 | 15.8 | 1.18 | 14.2 | 17.1 | 1.20 |
| 1950 | 5.3 | 13.4 | 12.1 | .90 | 11.7 | 17.7 | 1.51 |
| 1951 | 3.3 | 9.5 | 8.7 | .92 | 6.7 | 9.6 | 1.43 |
| 1952 | 3.0 | 10.9 | 8.0 | .73 | 7.0 | 10.0 | 1.43 |
| 1953 | 2.9 | 8.9 | 8.3 | .93 | 7.1 | 8.1 | 1.14 |
| 1954 | 5.5 | 14.0 | 13.4 | .96 | 13.0 | 14.7 | 1.13 |
| 1955 | 4.4 | 12.2 | 14.8 | 1.21 | 10.4 | 12.9 | 1.24 |
| 1956 | 4.1 | 11.2 | 15.7 | 1.40 | 9.7 | 14.9 | 1.54 |
| 1957 | 4.3 | 11.9 | 16.3 | 1.37 | 11.2 | 20.0 | 1.70 |
| 1958 | 6.8 | 14.9 | 27.1 | 1.81 | 16.5 | 26.7 | 1.62 |
| 1959 | 5.5 | 15.0 | 22.3 | 1.48 | 13.0 | 27.2 | 2.09 |
| 1960 | 5.5 | 14.6 | 22.7 | 1.55 | 13.5 | 25.1 | 1.86 |
| 1961 | 6.7 | 16.5 | 31.0 | 1.89 | 15.1 | 23.9 | 1.58 |
| 1962 | 5.5 | 15.1 | 21.9 | 1.45 | 12.7 | 21.8 | 1.72 |
| 1963 | 5.7 | 17.8 | 27.0 | 1.52 | 14.2 | 27.4 | 1.83 |
| 1964 | 5.2 | 16.1 | 25.9 | 1.61 | 13.4 | 23.1 | 1.72 |
| 1965 | 4.5 | 14.7 | 27.1 | 1.84 | 11.4 | 20.2 | 1.77 |
| 1966 | 3.8 | 12.5 | 22.5 | 1.80 | 8.9 | 20.5 | 2.30 |
| 1967 | 3.8 | 12.7 | 28.9 | 2.26 | 9.0 | 20.1 | 2.23 |
| 1968 | 3.6 | 12.3 | 26.6 | 2.16 | 8.2 | 19.0 | 2.31 |
| 1969 | 3.5 | 12.5 | 24.7 | 1.98 | 7.9 | 19.0 | 2.40 |
| 1970 | 4.9 | 15.7 | 27.8 | 1.77 | 12.0 | 23.1 | 1.93 |
| 1971 | 5.9 | 17.1 | 33.4 | 1.95 | 13.5 | 26.0 | 1.93 |
| 1972 | 5.6 | 16.4 | 35.1 | 2.14 | 12.4 | 36.3 | 3.11 |
| 1973 | 4.9 | 15.1 | 34.4 | 2.28 | 10.0 | 22.1 | 2.21 |
| 1974 | 5.6 | 16.2 | 39.0 | 2.41 | 11.5 | 26.6 | 2.31 |
| 1975 | 8.5 | 19.7 | 39.4 | 2.00 | 17.2 | 32.9 | 1.91 |
| 1976 | 7.7 | 19.7 | 37.7 | 1.91 | 15.5 | 34.0 | 2.19 |
| 1977 | 7.0 | 17.6 | 38.7 | 2.20 | 13.0 | 36.1 | 2.78 |
| 1978 | 6.0 | 16.9 | 40.0 | 2.37 | 10.8 | 30.8 | 2.85 |
| 1979 | 5.8 | 16.1 | 34.4 | 2.14 | 12.3 | 29.6 | 2.41 |
| 1980 | 7.1 | 18.5 | 37.7 | 2.04 | 14.6 | 33.0 | 2.26 |

Source: Walter Williams, "Government Sanctioned Restraints that Reduce Economic Opportunities for Minorities," Policy Review, Vol. 2 (Fall 1977) p. 14; Department of Labor, Bureau of Labor Statistics, Handbook of Labor Statistics 1980 (Washington, D.C.: U.S. Government Printing Office, 1980); Employment and Earnings (Department of Labor, Bureau of Labor Statistics), various issues.

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6 Walter E. Williams, "Government Sanctioned Restraints that Reduce Economic Opportunities for Minorities," Policy Review, Vol. 2 (Fall 1977), p. 15.

In the absence of a minimum wage law, blacks might be willing to work for a lower wage than whites. Discriminating employers would be penalized by incurring greater labor costs than non-discriminating employers that hire black workers. The non-discriminating firms would have lower production costs and could force discriminating firms out of business by charging a lower price. Competition in labor and product markets would therefore mitigate the effects of any such employment and wage discrimination.

Moreover, a lower minimum wage is gaining more and more acceptance in the black community. A recent survey by Data Black Public Opinion Polls, a national black polling and research organization, revealed that 37 percent of those questioned favored a lower minimum wage to reduce unemployment among teenagers, while 36 percent thought that such a wage would adversely affect adult employment.

## LABOR OPPOSITION

The biggest supporters of the minimum wage are not representative of the poor, but organized labor. Their support stems from their desire to protect union members from competition. Unions lobby for minimum wage legislation because these laws tend to increase the labor costs of nonunion competitors, which raises the demand, as well as wage rates, for union labor. It is for this reason that union leaders so adamantly oppose the youth subminimum.

## CRITICISMS OF THE YOUTH SUBMINIMUM

Opponents of the youth subminimum wage legislation maintain that the rise in youth unemployment was not caused by concurrent increases in the minimum wage, but by the impact of the "baby boom" and the resulting expansion of the teenage population. Clara Schloss, a consultant for the AFL-CIO and a member of the Minimum Wage Study Commission argues: "The minimum wage has had very little effect on teen employment. The minimum wage went up at the same time as the population bulge for teenagers went up."[7] This proposition is based on the premise that there are not enough jobs in the economy to go around. This true only to the extent that the minimum wage has destroyed many possibilities for job creation. Given demand, an increase in the supply of labor, in this case workers born during the baby boom, results in downward pressure on the wage. When the minimum wage prohibits the wage from adjusting to the forces of supply and demand, unemployment results.

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[7] Harrison Donnelly, "Youth Subminimum Pay Fate Tied to Adult Wage Floor," Congressional Quarterly, March 7, 1981, p. 421.

A second objection to the youth subminimum wage arises from the fear that a two-tiered minimum would result in unfair competition between youths and adults, i.e., it would encourage employers to substitute teenage labor for adult labor. Walter Williams points out that this is an example of the "lump of labor fallacy," where one person's gain must be accompanied by another person's loss. On the contrary, the subminimum would generate new employment opportunities by making it more profitable for an employer to hire and train marginal workers and expand output. Moreover, most of these jobs would be entry-level positions that would be more suited toward the youth labor market than to older workers. According to Williams: "For the most part, teenagers hired at the subminimum rate would fill new jobs or old jobs that would be reinstated. There might be ushers at movies again, for example, and hotels might decide to keep their corridors and windows cleaner."[8] These jobs may replace some of the self-service aspects found in many of the goods and services we purchase today, such as the self-service pumps at gas stations and salad bars in restaurants.

In an empirical study on the effects of the subminimum wage prepared for the Minimum Wage Study Commission, Michigan State University economist Daniel Hamermesh finds that a 75 percent subminimum would increase teenage employment by about three percent or 250,000 jobs. His findings also indicate that nearly nine out of every ten jobs created for teenagers as a result of a youth differential would not come at the expense of adults. The Commission's own staff economists view this estimate as overly conservative and believe that a youth subminimum would create employment opportunities for as many as 450,000 young people. The effect on adult workers is minimal because the low labor costs would reduce prices and increase business activity, which would benefit all labor.

Furthermore, the two bills proposed by Senators Hatch and Percy would prohibit employers from engaging in such substitution. Even in the absence of legal penalties, however, employers would be unlikely to fire existing workers to hire new ones because of the high costs associated with employee turnover. Examples of such costs include replacing experienced and trained workers.

Others argue that the subminimum wage would yield windfall profits to firms employing large numbers of young workers by significantly reducing their labor costs. This argument, however, ignores the fact that competition in the product market would lower prices to a new competitive equilibrium, thereby eliminating any windfall.

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8 Singer, op. cit., p. 148.

## CONCLUSION

The original purpose of the minimum wage was to alleviate poverty by insuring an adequate standard of living for all workers. George Stigler has contended that government interference in low-wage labor markets is "neither an efficient not an equitable device for changing the distribution of personal income."[9] Advocates of the minimum wage assume that the benefits accrue to the needy, yet the Commission's own report reveals that less than one-third of an increase in the minimum wage would go to families with pre-tax earnings of $10,000 or less. Furthermore, the most needy members of our society are likely to suffer even greater losses by being denied employment and/or an opportunity to build for the future through training and experience. In essence, "the minimum wage serves only as a tax from the poor to the poor."[10]

America's young people are anxious and willing to work, but without a youth differential, teenagers will continue to bear the burden imposed by minimum wage legislation. Current debate regarding the youth subminimum wage should be based on the vast body of empirical evidence, not on the biased report of the Minimum Wage Study Commission. An objective evaluation of the facts would certainly mandate a lower minimum wage for today's youth. Because the minimum wage not only affects the youth labor market, but also young adults, the less educated, the elderly, etc., a far better proposal would be one eliminating the minimum wage altogether.

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9 George J. Stigler, "The Economics of Minimum Wage Legislation," American Economic Review, Vol. 36 (June 1946), pp. 358-65.

10 Finis Welch, Minimum Wages: Issues and Evidence (Washington, D.C.: American Enterprise Institute, 1978), p. 25.