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MANUFACTURED IN THE UNITED STATES OF AMERICA

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The Home-Work System

In simple language, a minimum wage law is nothing more than a government order that workers must not work unless they find jobs paying at least the stated minimum. It is an order to employers that they must pay workers the minimum, or not employ them at all. It is a direct order that is enforced by the coercive powers of the state.

The minimum wage movement came into existence, in concert with the union movement, as a consequence of severe criticism of "sweat shops" in the home-work system, which permitted workers to perform manufacturing services at home rather than in a factory. The system, which enabled women and children to participate in simple production, constituted a major threat to the union movement. To eradicate this threat and all other competition from low-cost labor, labor unions, since their very beginning, have called for government intervention.

Minimum wage legislation originated in New Zealand in 1894 and came to England in 1909, when Parliament established trade boards with the power to fix minimum rates. In the United States, the movement at first was confined to state legislation, applicable to women and children only. The federal government entered the field during the 1930s when it passed labor laws with limited application, such as the Bacon-Davis Act of 1931, the Walsh-Healey Public Contracts Act of 1936, certain provisions of the U.S. Housing Act of 1937, the Sugar Act of 1937, and the Civil Aeronautics Act of 1938. In the same year, the Fair Labor Standards Act provided much broader coverage and established a minimum wage level of $.25 per hour, covering employees of all businesses engaged in interstate commerce or in the production of goods for such commerce. Later amendments to the F.L.S.A. raised the minimum wage to the present level.[1]

There is an infinity of political errors which, once adopted and enacted, become principles of statesmanship. Labor legislation summarily disposed of the home-work system, and then set out to raise wage rates and improve working conditions by political force. To most political parties, this is supreme statesmanship that takes precedence over all other considerations. Unfortunately, it is also the root cause of mass unemployment that is inflicting immeasurable harm on millions of innocent victims.

An unhampered labor market offers opportunities to anyone seeking employment. The pressures of competition, by both workers and employers, establish a wage rate at which everyone eager to work can find a job, and every employer eager to hire more help can find more workers. When government sets out forcibly to lift wage rates above those set by competition, chronic unemployment emerges. It causes countless economic distortions, reduces economic output, lowers personal incomes, and aggravates the plight of the poor.

A wage rate set above a person's own productive contribution causes his unemployment, pricing him right out of the labor market. Surely, minimum wage legislation does not directly affect a worker whose training and skills earn him a wage in excess of the minimum, but it seriously jeopardizes the employment of all those unskilled workers who produce, and consequently earn, less than the minimum. In the United States, minimum wage legislation does grievous harm to millions of unskilled laborers, especially among the racial and ethnic minorities—Negroes, Puerto Ricans, Chicanos, Mexicans, and American Indians.

The Victims

Most critics of minimum wage legislation do not concern themselves with the propriety and morality of political intervention in the production process. They accept the rationale of political supremacy and government power, but lament the evil effects of unemployment on some highly visible groups of victims, such as young people, especially black teenagers; therefore, they are designing special programs for teenagers and other groups, calling for massive government expenditures on their behalf. Unfortunately, they are overlooking most of the affected population.

Recent research confirms that only about one-third of low-wage earners are teenagers; almost one-half are twenty-five to sixty-four years of age; two-thirds of the low-wage population are believed to be female; and some ten percent are individuals sixty-five years old or older. Altogether they comprise some ten percent of American labor. Other estimates are even higher. Of course, these workers who are earning the minimum or near-minimum wages are the very workers who tend to be, or are in danger of being, displaced by wage legislation.[2]

It is an unfortunate fact that many minority youngsters, with lower levels of education, training, and experience than white youngsters, are often less productive. In an unhampered labor market, they would not be able to earn as high a wage as their more productive competitors, but would find employment at lower rates. When the minimum is raised above their productive ability, they are likely to be dismissed, or not to be hired. This explains why the unemployment rate of black youth in recent years has ranged between 40% and 50%, which is double the rate for white teenagers.

If we add those individuals who, in frustration and desperation, have given up their search for employment, the unemployment rate among black youth may, in our estimate, exceed 70%.

Other workers with similar limitations find it equally difficult to find employment at the minimum rate. Unskilled women, students seeking summer employment, and especially unskilled service workers in hotels, restaurants, hospitals, laundries, automotive service stations, are living continuously with the dangers of unemployment due to minimum wage increases. It is true, not every minimum wage worker loses his employment when the minimum rate is raised. Employers may seek to offset the boost with economies in other labor expenses, or through exaction of greater effort and performance by the covered workers. Wherever such adjustments are impractical, the submarginal workers are laid off; that is, all those workers whose costs exceed the anticipated price of the incremental goods produced or services rendered.

Obviously, unemployment is more severe in industries employing a great many unskilled workers than in other industries relying mainly on professional and highly skilled labor, and it is more keenly felt in cities with concentrations of unskilled labor than in prosperous suburbs. For the South, with its millions of unskilled Negro workers, every minimum wage boost is a calamity. In Puerto Rico, it is an unmitigated disaster.

No matter how tragic the economic effects may be on certain groups of victims, we must not overlook the psychological harm and the moral wrong that are inflicted on them. Condemned to idleness and uselessness in a highly productive society, and barred from making their own contributions, many, in desperation, are turning to vice and crime. The inordinate national crime rate attests to a moral decay that is working evil in the centers of unemployment and public assistance. Let us not forget the productive members of American society, who not only must forego the valuable services which the disemployed workers could render, but also are forced to support them through taxation and other exactions. In return, they are compelled to live in constant fear of crimes against their persons and property.

The Beneficiaries

It is true, a few minimum-wage earners actually benefit from a mandated increase. The law that raises the minimum renders submarginal all those workers who produce and earn less than the new minimum. It withdraws them from productive employment and deprives economic production of their services, which affects the labor market just like the conscription of millions of young men into military service. Their withdrawal from productive employment raises the marginal productivity of the remaining workers and, therefore, increases their wages. It also lifts some submarginal labor above the threshhold of employability. If the minimum is raised from $5 to $5.50, the most productive among the excluded workers will be lifted to the new minimum in a declining order of productivity, that is, first workers who were earning $5.49, then others earning $5.48, $5.47, etc.; however, consumer reluctance to bear the higher labor costs sets a narrow limit to the lifting process, which consigns most subminimum workers to the new army of the unemployed.

Political force may disrupt economic activity and forcibly benefit some workers at the expense of others. It cannot stimulate production and promote universal well-being by withdrawing millions of able workers from economic production. If by law or decree a government actually could raise the wages and improve the working conditions of all workers, it would be cowardly and irresponsible to be content with $2, or $3, or $4 minimums. Let us make it $10 per hour, or better yet, $100 an hour. If a minimum wage law actually could improve the working and living conditions of all people, let us urge the governments of undeveloped countries to imitate our example. Surely, it would alleviate the poverty and suffering of the masses in India, China, and many African and Latin American countries. Actually, it would create horrendous unemployment and jeopardize the very survival of the poor. Neither the U.S. government nor foreign governments can improve general working conditions by law or decree; only rising production can bring it about.

Nor can a government grant social benefits that do not reduce the workers' take-home pay. The incidence of any and all benefits falls on the wage earner. For an employer, the worker's take-home wage is just another component of the total price he must pay for the services of a worker. He would not be an employer for long if he were to ignore all other employment costs such as retirement and pension costs, paid holidays and vacations, health care insurance, profit-sharing plans, welfare funds, or any other fringe benefits, and it does not matter to him whether he may deduct the fringe benefit costs from the worker's pay or must make direct payment to third parties. In both cases, the burden falls on the employee. The employer is concerned only with the total price he must pay for the services of a worker.

Wages and Benefits

The minimum wage, as set by government, must not be confused with the total employment costs of a worker, which in every case greatly exceed the former. Corporations that offer equal benefits to all their employees may grant fringe benefits that amount to 35% of executive pay and to 100% or more of a minimum-wage-earner's pay. Even without any such contractual privileges, the benefits mandated by government do add considerably to total costs. There are Social Security exactions and heavy levies for unemployment and workmen's compensations. The $3 minimum wage may actually amount to a $5 minimum cost, and the $5 minimum wage to $10 minimum cost. It is, therefore, misleading to speak of a "small" boost of the minimum wage rate, as if the mandated and contractual benefits would remain unchanged. The small minimum boost may actually amount to a sizeable increase in total labor cost.

For an employer, it is irrelevant whether he allocates 5% of employee wages to fringe benefits or 95%. His only concern is the total price he must pay to secure the services of a worker. If government forces him to pay more than the worker is expected to contribute to production, he can be expected to dismiss the worker, and again, it does not matter whether government mandates an increase of take-home pay or of fringe costs. A $1 boost in the rate of minimum wages has the same ill effect on employment as a $1 rise in the levies for Social Security and workmen's compensation.

Through their labor, workers pay for all of the fringe benefits they are receiving. They also make good for their on-the-job training by receiving low wages that allow for the expenses of their training. When the minimum wage is raised, employers may react to the boost in labor cost by reducing their expenditures on benefits. In particular, they may respond by reducing the amounts spent for on-the-job training.

For young people, the most important fringe benefit is the opportunity to acquire new skills and knowledge, which enhances their productivity in the future. Most jobs offer an opportunity to learn through formal training programs or informal learning by experience. On-the-job training not only imparts basic skills, but also stimulates motivation, nurtures a sense of responsibility, and generally prepares young people for rewarding roles in productive society. If they fail to acquire the experience, training, competencies and credentials in their formative years, they will have difficulty holding regular jobs in their adult years. Any barrier to on-the-job training inflicts serious harm on them.

Millions of young workers who are disemployed by the minimum wage may never acquire the general training and specific skills that make them useful members of society. They may never learn the basic discipline and ethos of labor that are so essential in our society. Instead, prolonged unemployment so early in life may prepare them for a precarious and bitter existence on public welfare. More millions may remain employed at or near the minimum, but their on-the-job training may be reduced or eliminated as a result of mandated minimum increases, which may keep them marginally productive throughout life. Their more creative fellow men not only must forego their valuable cooperation, but may even be called upon to assist them and their dependents.[3]

Extension of Coverage

Federal minimum wage legislation had its beginnings more than forty-five years ago as part of the 1938 Fair Labor Standards Act. From its very inception, it erected insurmountable barriers to the employment of unskilled workers, especially in the South and in Puerto Rico. Since then, it has grown into the most calamitous instrument of government intervention that denies productive employment to millions of willing and able Americans. No other policy conducted by the U.S. government has more tragic effects on the daily lives of so many people than this legislation.

Several amendments to the Act not only pushed the rate to ever more restrictive levels, but also extended the coverage to include ever more employees. At the beginning, the basic minimum, as a percentage of average manufacturing wage, was estimated at 41.7%; for 1981 it amounted to 51.9%. In 1938, the percentage of covered workers stood at 43.4%; in 1981 it was estimated at 83.8%.[4] If the coverage provided by various state laws is added to the federal coverage, the combined rate may exceed ninety percent of all non-supervisory workers.[5]

It is rather natural for government to expand its sphere of control and power. If it is called upon to secure minimum wages for some workers, it may want to extend the benefits to all workers. If government can serve the public good by setting the wage rates for some workers, it may serve it better yet by setting the wage rates for all workers. The ninety-percent coverage, therefore, can only be an interim step on the way to total coverage.

Unfortunately, this gradual extension of coverage tends to multiply the unemployment effect until, with full coverage, it invokes the maximum rate of unemployment. As long as the minimum applies only to a small number of occupations, the workers displaced from covered jobs can seek employment in uncovered production. They shift to uncovered industries and employers, which tends to depress those wages through increased job competition. When the coverage is extended, the shift accelerates from covered unemployment to uncovered jobs, which widens the wage differential in direct proportion to the coverage. A small coverage generates a small difference in wage rates; a large coverage brings forth a large difference. Total coverage obviously eliminates the difference, but creates maximum unemployment.

Minimum wage legislation provides a beautiful example of the principle that government intervention not only makes matters worse, but also tends to breed ever more intervention. The minimum wage covering a few workers causes wage rates to decline in uncovered employment, which invites the extension of coverage to more workers, which in turn brings forth ever wider wage differences calling for more coverage, until all workers are covered and the difference is eliminated. Unfortunately, total coverage guarantees maximum unemployment, which brings forth the greatest conceivable income difference—between the workers still employed and the army of unemployed.

Indexing the Minimum

Minimum wage legislation can be harmless, if the rates are set below the unhampered market rates; but that, after all, is not the intent of its political sponsors, who seek to interfere with the market process. Yet, the ominous effects of minimum wages set above the rates established by the market may be alleviated by two other factors: rising labor productivity, which may lift more workers above the minimum barrier; and soaring inflation, which lowers minimum wages in terms of purchasing power. The former may have lessened the impact of the legal minimum during the 1960s, when labor productivity managed to rise a little. Stagnant, or even declining, labor productivity during the 1970s, when U.S. government deficits consumed productive capital en masse, aggravated the restrictive effect of legal minimums and caused real incomes to decline.

Throughout this period, soaring inflation greatly lowered the real costs of labor, including the real minimums, which permitted the temporary employment of some workers who previously had been unemployable. The opposing effects of legislative mandates raising the minimum and the inflation depreciating it is causing large swings in the effective minimum. According to Finis Welch, it ranged between 30% of the manufacturing-wage average in 1949 and 55% in 1968.[6]

Observing the depreciation of their mandated minimums, the sponsors deem it necessary frequently to readjust the minimum to soaring goods prices. From 1961, when inflation began to accelerate in earnest, until 1981, Congress enacted eleven adjustments, which raised the minimum from $1 per hour to $3.35 an hour. To simplify the adjustment process and prevent the silent nullification of Congressional efforts by inflation, some sponsors propose to index the federal minimum by tying it permanently to the average industrial wage. The 1977 amendment, which established a Minimum Wage Study Commission, therefore called for an investigation of minimum wage indexation.

Indexing wages, rents, interest rates, and goods prices obviously means government control over wages, rents, interest rates, and prices. It aims at freezing present conditions, preventing all future changes and adjustments, unless approved by political authority. Minimum indexation would seek to preserve the Congressional effort by freezing the real minimum at 55% of the manufacturing-wage average and thus eliminating the inflation swings. This means, unfortunately, that unemployment would be stabilized at its highest possible rate determined by the minimum. It would permanently deny millions of unemployed workers a longed-for reprieve, provided temporarily by inflation.

Offsetting the Minimum

In a sagacious monograph,[7] Walter J. Wessels makes the cogent point that employers tend to react to minimum wage increases by seeking to offset the added expenditures through reductions in other labor costs. They may cut year-end bonuses, redefine the worker's share in profit sharing, and reduce commissions and work guarantees. They may moderate non-wage expenditures, commonly called "fringe benefits," such as paid vacations and sick leave, pensions and other retirement benefits, life, accident and health insurance, or training programs and educational allowances. They may even reduce expenditures on proper supervision and management, an action which tends to impair and aggravate working conditions. They may insist on more effort and application. As fewer jobs are available, employers may exact greater production from their minimum-wage workers. They may assign less desirable working hours and conditions for which they otherwise would pay higher rates. In short, they can be expected to react by making adjustments to offset the minimum-wage boost.

Even if some employers should be able to offset the higher costs of a mandated minimum, Wessels argues, it nevertheless impairs the conditions of all covered workers. They may have preferred the fringe benefits over the pay boost, the paid vacations or the major medical insurance over the cash payment mandated by Congress. Where employers are unable to fully offset a minimum wage boost, which tends to lead to disemployment, the idled workers will seek jobs that are not covered by the minimum wage, or they may join the "underground economy" where labor summarily ignores the law by working for wages below the minimum. Their appearance on the uncovered labor market or in the underground market, which economists estimate to exceed 30% of minimum wage labor,[8] tends to further reduce those wages. All affected labor, therefore, tends to be worse off than before.

Surely, employers do react to mandated minimum wage increases, but we must not underestimate the great difficulties they encounter in lowering other labor costs. Once benefits have been granted, it is nearly impossible to rescind them. To reduce benefits is to invite universal resistance and hostility, which may impair labor productivity and thus raise production costs. Moreover, it is virtually impossible, in the allocation of fringe benefits, to discriminate against minimum wage labor. This is why most employers offer identical benefits to all their workers, regardless of position and income. To ignore minimum wage labor, or even slash its given benefits, is to invite resentment, conflict, and strife. It is generally much easier and also more economical to dismiss the labor made submarginal by the mandated minimum boost than to seek adjustment through fringe-cost economies.

For superior management, it may be possible to lead and exhort labor to higher productivity. There is an untapped reservoir of productivity even in the best-run office and plant. Brilliant management seeks to tap this reservoir through guiding and teaching by example. It imparts the love of work and inspires enthusiasm for work well done; and, above all, it exemplifies that there is no work so base that man may not exalt it, no work so dull that he may not enliven it. There is no minimum labor that may not lead to maximum position and income.

Most business managers, unfortunately, are incapable of exacting more effort and application from their employees, which is casting doubt on their ability to offset mandated wage boosts. Even if they were able to adjust, the number of affected workers would be rather small. Offsetting adjustments cannot create jobs for those millions of unskilled workers whose usefulness and productivity lie below the legal minimum. The high-school dropout from the Bronx, who may contribute one dollar per hour of work, remains unemployable at $3.35 per hour—no matter how diligently employers are readjusting their labor expenses.

Offsetting adjustments do not affect the vast majority of American workers who are presently earning more than the minimum. They may, at best, involve only a small number of people who are presently earning the legal minimum and are contributing an amount sufficient to cover this minimum and other employment-related costs. In many cases these other costs are also mandated, which clearly makes them unadjustable. In fact, they actually rise together with the minimum wage. Employer contributions to Social Security and workmen's compensation do rise and further raise the costs of the minimum wage boost. They may also add to the administrative expenses of accounting, withholding, declaring, and disbursing the additional funds to the appropriate government authority. While such costs may be negligible in a smoothly functioning accounting department, they are very burdensome and highly disruptive for a small businessman considering the employment of a few minimum-wage laborers.

The offset possibilities must not be overstated. They are narrowly limited to contractual benefits that may be adjusted by agreement between the contract parties, but in some cases, these benefits are negligible. They may be less valuable than a mandated wage boost together with the mandatory fringe adjustment, which precludes any offset. If they are equal to the ordered raise, all contract fringes would have to be eliminated to effect any offset; but such a withdrawal of all contract fringe benefits would be even more detrimental to amicable labor relations than their mere reduction. It surely would impede labor productivity and raise production costs.

From the World of Politics

Every well-known economist has voiced his concern about minimum wage legislation,[9] and yet, it is surviving sober reasoning and cogent arguments, and living on in the sphere of political incentives. Few Americans actually believe that minimum wage legislation is truly in the workers' interest, that it increases purchasing power and reduces poverty, and yet, many support it for political reasons. Labor unions and their members benefit significantly from a legal elevation of wages paid by competing industries using low-productivity, low-wage workers. It hampers their competition with union labor, and limits consumer preference for goods produced and services rendered by low-wage labor. Similarly, capital-intensive industries using relatively skilled labor may want to redirect consumer choices by raising the costs of low-wage industries.

Most of the support for minimum wage legislation comes from groups that are fully aware of its unemployment effects. Many Americans in the industrial states of the North and Northeast use it knowingly as a barrier to the industrial migration from the states to the South. Since World War II, many companies have left the North to take advantage of lower labor costs and other advantages in the South. To prevent this industrial migration and to stifle emerging Southern competition, the Northern politicians usually favor high minimum wages.

Other supporters who are aware of the harm done to unskilled workers are convinced that the beneficial effects, as they see them, tend to outweigh the ill effects. Their blind faith in political action leads them to believe that the ill effects can be alleviated by new governmental efforts, such as neighborhood youth corps, job corps, public works programs, etc. Their faith in government marches at the head of the armies of government.

Notes

1 For a detailed chronology of minimum wage legislation from thirteenth century France to the 1930s in the United States, cf. E. R. Nichols and J. H. Baccus, *Minimum Wages and Maximum Hours* (New York: H. W. Wilson Co., 1936), p. 41 et seq.; for an American history cf. U.S. Dept. of Labor, *The Development of Minimum Wage Laws in the United States, 1912 to 1927* (Washington, 1928).

2 Cf. Finis Welch, *Minimum Wages* (Washington, DC: American Enterprise Institute, 1981), p. 13; also Edward M. Gramlich, "Impact of Minimum Wages on Other Wages, Employment and Family Incomes," *Brookings Papers on Economic Activity, 2,* 1976, pp. 409–451; Walter E. Williams, *Youth and Minority Unemployment* (Stanford, CA: Hoover Institution, Stanford University, 1977).

3 Cf. Masanori Hashimoto, *Minimum Wages and On-the-Job Training*, (Washington, DC: American Enterprise Institute, 1981).

4 Cf. Finis Welch, *Ibid.*, p. 3.

5 Most states have complex minimum wage legislation of their own, with rates typically below the federal rate. In a few states—Alaska, California, the District of Columbia, and New York—the rates usually exceed the federal minimum. In other states the differential has been shrinking in recent years.

6 *Ibid.*, p. 6.

7 Walter J. Wessels, *Minimum Wages, Fringe Benefits, and Working Conditions* (Washington, DC: American Enterprise Institute, 1980).

8 Orley Ashenfelter and Robert S. Smith, "Compliance with the Minimum Wage Law," *Journal of Political Economy,* April 1979, pp. 333–350.

9 Ludwig von Mises, *Human Action,* (1949), 3rd ed. (Chicago: Henry Regnery Co., 1966), pp.

769–777; Arthur Burns, *The Business Cycle in a Changing World* (New York: National Bureau of Economic Research, 1969), pp. 216–219; Martin Feldstein, "The Economics of the New Unemployed," *Public Interest*, Fall 1973, pp. 14–16; Milton Friedman, *Capitalism and Freedom* (University of Chicago Press, 1962), pp. 180, 181; George J. Stigler, "The Economics of Minimum Wage Legislation," *American Economic Review*, June 1946, pp. 358–365; Walter Williams, *Youth and Minority Unemployment*, Report for the Joint Economic Committee, July 6, 1977; even Paul Samuelson must admit that minimum wage rates "often hurt those they are designed to help." Cf. *Economics*, 11th ed. (New York: McGraw-Hill Book Co., 1979), p. 369.

Publisher's Postscript

This tract is a reproduction of Chapter 3, entitled "Minimum Wages" from Hans F. Sennholz's classic, *The Politics of Unemployment.* It explodes the political appeal of minimum wage legislation, which permits politicians to buy votes without straining their budgets. The motives may be as bad as the laws. Labor unions call for higher minimums that get rid of unskilled workers and, hopefully, create more jobs for members. Society is forced to forego the services of unskilled people, but is expected to grant them generous unemployment compensation and public assistance.

In fact, the minimum wage law is only the tip of the iceberg. Many other politically motivated restrictions on the relationship between employers and employees substantially raise the cost of labor, hampering the market in its production of high-quality, competitively priced goods and services.

In *The Politics of Unemployment,* labor legislation is analyzed in terms of the market's supply and demand for employment. Each restriction on the freedom of workers and employers to contract for work is dissected to reveal the pernicious effects of the political force being applied. Unemployment is a political phenomenon, not an economic one. Find out what the politicians are doing to *your* work environment! Order your copy of *The Politics of Unemployment* today! (c., 356 pages, $19.95 plus $2.00 for shipping and handling)

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