A Higher Minimum Wage Won't Lead to Armageddon

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Venture capitalist Nick Hanauer is one of the nation's most important advocates for the minimum wage. He helped spearhead Seattle's successful fight for $15 an hour, and is now helping the campaign to extend that number to the entire nation. Hanauer's support goes beyond money, however -- he is very outspoken on Twitter and on the internet, penning many long and forceful articles in support of a higher minimum wage and lambasting the status quo in economics.

In a recent post in Democracy Journal, Hanauer wrote that I was predicting "economic Armageddon" from minimum wage increases:

> Minimum wage opponents continue to deride every proposed increase as a surefire job-

> killer, while reporters and pundits reliably characterize the passage of every minimum wage ordinance and statute as a dangerous experiment...No one captured this conventional economic orthodoxy better than Noah Smith...in an article titled "Finally, an Answer to the Minimum Wage Question"...The core assumption of Smith's piece is a so-called "economic theory"—asserted as if it is a law of nature—that if the minimum wage goes up, employment must come down.
> To be fair, Smith and the others above are not the first to predict economic Armageddon if the minimum wage was increased.

This isn't an accurate summary of my position on the minimum wage. I don't think an economic Armageddon will result from any of the minimum wages currently being contemplated, including the Fight for $15 movement.

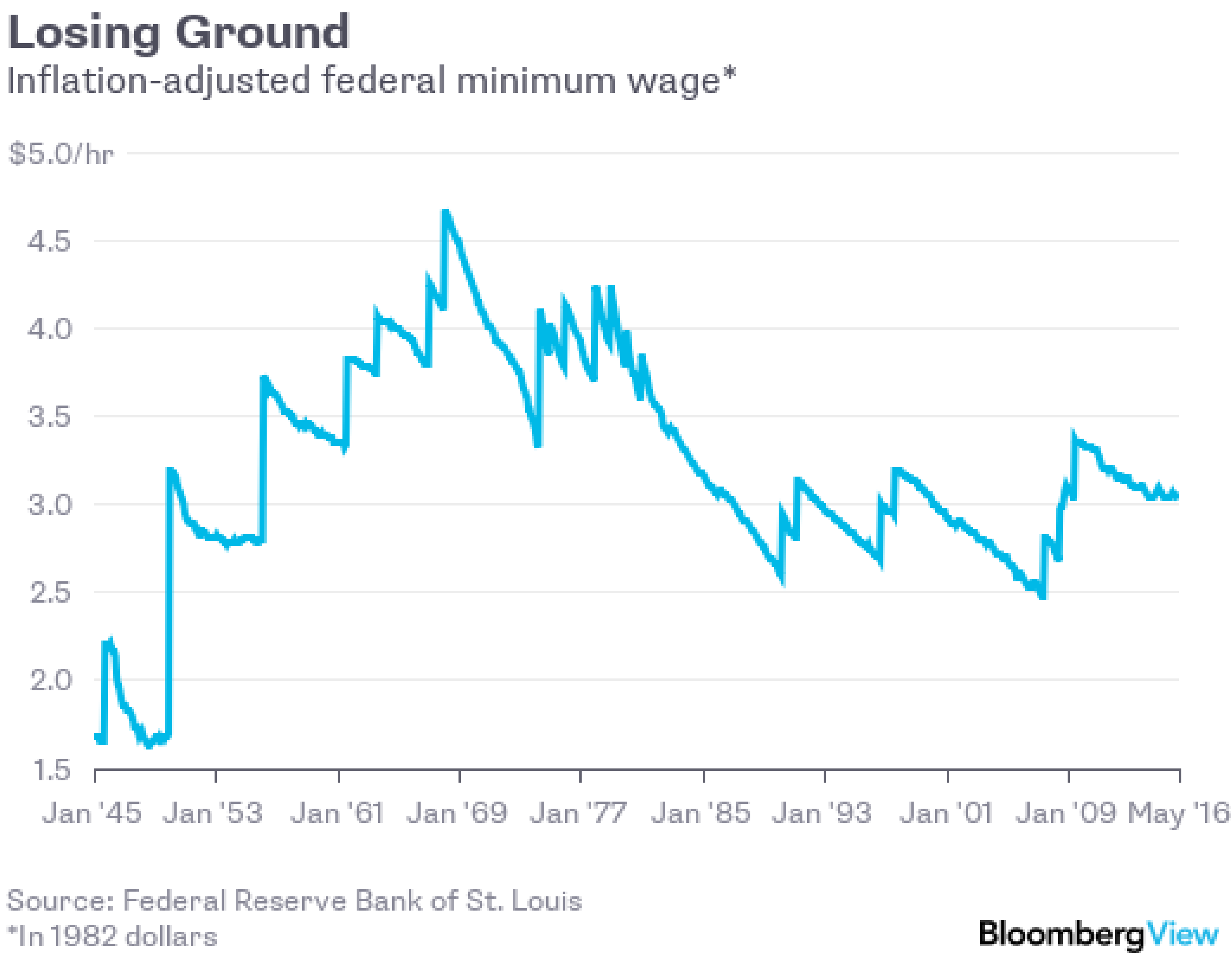
Nor do I embrace the economic theory in question as if it is a law of nature. The theory in question -- the basic, Econ 101 theory of labor supply and demand in a perfectly competitive market -- is unsuited to the task of sorting out the minimum-wage debate. In fact, in a model where employers have market power, a minimum wage law can *raise* employment instead of lower it. That kind of model should be taught in every introductory economics class.

QuickTakeMinimum Wage

I've often argued against the use of the kind of apocalyptic minimum-wage theory Hanauer is talking about. What I think we should do is to look at the data. There have been many minimum wage increases in the past, and we can study these historical experiments to get a rough picture of what to expect if we increase the minimum wage.

On this point, Hanauer and I are in agreement. As his historical evidence, he cites a research report by the National Employment Law Project. This report looks at past increases in the federal minimum wage, and finds no correlation between minimum wage levels and employment levels.

That's a good start. But this type of historical national-level correlation, while valuable, isn't the best evidence we have. There are some confounding factors, for sure. Here's the history of the federal minimum wage in the U.S., adjusted for inflation:



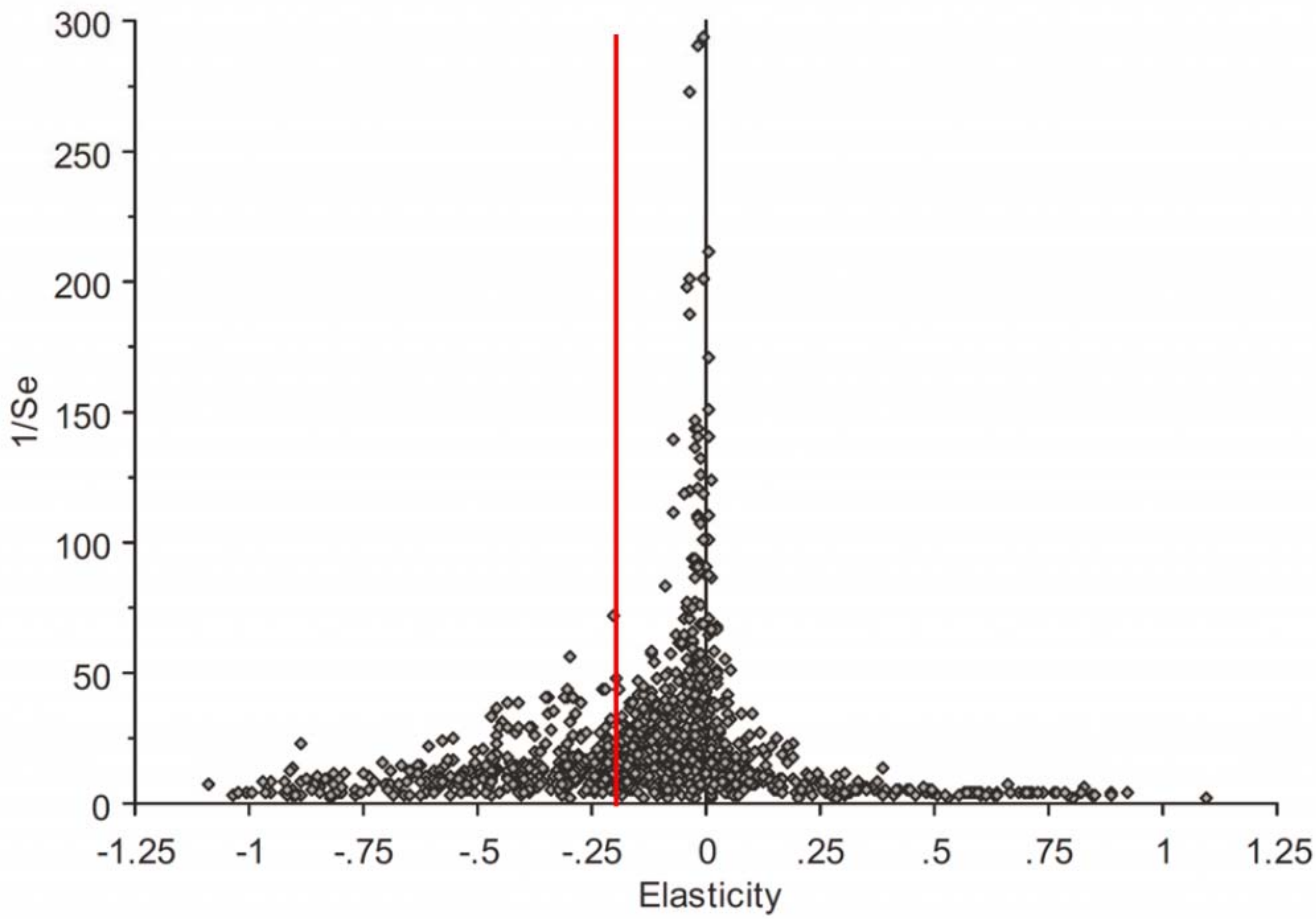
As you can see, all the big increases in the minimum wage came between 1950 and 1970. Since then, it's been falling. Remember that the U.S. economy was booming between 1950 and 1970, while it has grown more slowly in most of the years since. Total factor productivity growth has also slowed since about 1970.

So if we just look at the evidence provided by the NELP report, we see at least three possible conclusions. The first is that minimum wages don't really affect employment -- at least, not at the levels we've tried so far. The second is that minimum wage hikes have some negative effects on employment, but that these were swamped by the growing economy in the postwar economy. The third is that minimum wages actually *cause* fast economic growth, through some mechanism not yet understood. Studies like NELP's, which rely on time-series correlations, can't really tell us which of these stories is correct.

Fortunately, there's lots of other evidence available. Many empirical economics papers have examined the effects of real-world minimum wage increases, usually at the local level. A typical study looks at a single minimum wage hike, and compares the place that hiked minimum wages to other, supposedly comparable places. Some of the studies were well-done, others were doubtless botched. But we can gather these papers into a meta-analysis and look at the overall picture.

Economists Hristos Doucouliagos and T.D. Stanley did this in 2009, looking at a large set of studies that focused on young workers (who are believed to be most affected by minimum wages). Here, via University of Wisconsin-Madison economist Menzie Chinn, is their result in a picture:

FIGURE 2
Trimmed Funnel Graph of Estimated Minimum-Wage Effects (n = 1,424).



On the horizontal axis, we see the strength of the effect of minimum wages on employment. A positive number means that a minimum wage is found to increase employment; a negative number means it decreases it. On the vertical axis, we see the precision of the studies -- a higher point means a study with a bigger sample size, indicating greater accuracy.

So what does this graph tell us? The average effect found in the econ literature is an elasticity of about -0.2 as indicated by the vertical red line. That means that a 10 percent increase in the minimum wage would decrease employment by about 2 percent. So if we doubled the minimum wage -- a 100 percent increase -- we would expect to see the employment of young people go down by a fifth.

That's a small but real effect -- a $15 federal minimum wage might throw a million kids out of work. We would have to balance that negative effect against the broad-based positive effect of raising lots of low-income people's earnings. Balancing the good against the bad is necessary to make a decision.

But, as Menzie Chinn notes, the most precise studies put the effect at a much smaller level -- maybe about 0.05 percent. That means that doubling the minimum wage would decrease youth employment by only 5 percent. That's a very tiny effect.

So the empirical evidence so far says that minimum wages have usually had a minimal negative impact on employment. Of course, raising the federal minimum to $15 is a much bigger increase than we've seen before. That's why experiments like Seattle's plan to raise the floor to that level are so important -- they will give us newer, better information than the old studies.

That is what my original post argued. And it's as true now as it was then.

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