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**The Economics of Minimum Wages**

Samuel Bowles

Santa Feans should be proud of our City Council members. In a series of hearings and other meetings they have listened hard to thoughtful and heartfelt testimony from both sides of a hot issue: the proposed increase in the minimum wage. The issues are complex, but I hope to persuade you that the question need not be divisive.

For you who are skeptical on this score, here is a true story. On the morning of January 5, 1914, Henry Ford announced that he would pay his workforce a minimum of five dollars for an 8-hour day, at once shortening the work day and more than doubling the hourly rate of pay for the vast majority of his employees.

He did not do it for the workers: Ford’s profits rose, supported by a more than doubling of the output per hour of production labor. Ford was to become a household word around the world and Fordism a particularly American approach to labor relations: pay well and expect good work.

Santa Fe is not Detroit. What do we know about the likely impact of an increase here?

By far the most searching answer to this question is found in the research of two authors recognized around the world as the top economists doing statistical studies of labor markets, David Card of the University of California and Alan Krueger of Princeton. Neither author, to my knowledge, has taken any public position pro or con about “living wages,” or raising the minimum wage. Until ten years ago most economists adhered to a theory that predicted that minimum wages killed jobs. But their prize-winning book proved blackboard economics wrong.

Card and Krueger investigated the effect on teenage employment of the increases in the federal minimum wage in 1991 and 1992. They compared high wage states such as California and Massachusetts, where almost all workers were already paid in excess of the minimum, with low-wage states like Mississippi, where the increase affected far more workers. They found – to their and most economists’ surprise -- that the low-wage states experienced employment gains relative to the states in which the increase in the minimum had less bite.

But their most telling evidence is based on a study of fast food outlets before and after the 1992 increase in New Jersey’s minimum wage. Comparing employment in New Jersey and Eastern Pennsylvania, the authors found that employment in New Jersey actually increased
compared to employment in Pennsylvania, though the difference was not large.

A restaurant industry funded counter study came up with the prediction that “a ten percent increase in wages results in a 2.2 percent decrease in employment.” Opponents have used this estimate to say that the ordinance will hurt low-wage Santa Feans. In this respect, they follow a venerable tradition, beginning with those who opposed the 19th-century prohibition of child labor on grounds that it would impoverish working families and those who opposed the 8 hour day as an infringement on the liberty of workers.

Suppose the business sponsored estimate of 2.2 percent were true. What would this imply for our workforce? Most individuals in low-wage jobs have shorter than average job duration, and little job security. Movement between jobs is frequent. Let us consider the well-being of such a worker over a period of years. Suppose she worked for $7.75 an hour as a cleaner at a hotel, and that the living wage ordinance raised her pay to $8.50. That’s a ten percent increase in hourly pay. According to the anti-living wage business study, she could expect to be employed 2.2 percent less of the time, or perhaps to be employed same number of weeks over this period, but 2 per cent fewer hours per week.

Here’s a reality check: ask the next person you run into if they would accept an offer of an 8 percent increase in annual income along with a 2 percent reduction in working time. Or next time you have a meal out, ask your server. And remember, these numbers come from a study paid for by the opponents of the living wage ordinance.

What about the possibility that a higher minimum wage will squeeze profits? On the basis of studies done in New Orleans and other cities, and taking account of the substantial increase in the minimum wage proposed here, the total costs in the hotel and restaurant business in Santa Fe could rise 5 or 6 percent. The reason the cost impact is so small is that the pay of low-wage employees is a small part of the total, once the cost of the physical plant, interest on borrowed funds, the materials, profits, management salaries, taxes and the rest are considered. Cost increases in most other parts of the Santa Fe economy would be much smaller.

Productivity can increase to offset the cost hike, as it did at Ford. Paying a person more costs you more, but it buys you a different attitude and a stronger commitment to the firm. Good wages and a good attitude are at least important for productivity as are a worker’s know-how.

But the productivity response may not fully offset the cost increase. In this case management and owners might take home a bit less. If they did, it would not put a dent in the historically unprecedented explosion of inequality of earnings and wealth this country has experienced over the last two decades. But it would probably be a good thing for Santa Fe.
And the rest of the country might thank our business people for their good example.

Finally, prices can rise. Would this drive away jobs? What impact on our tourist and other businesses would we expect if there was no productivity response, and if the upper echelon earners were not willing to bear any of the costs? What differences would price increases in the neighborhood of 6 per cent make (taking the above estimate of the cost increases in hotels and restaurants)?

Another reality check. Next time you eat out and somebody at the next table sounds like he came from Massachusetts, ask if he would have stayed home, or spent his vacation in Albuquerque or Cape Cod, if his $25 meal had instead cost $26.50 or his $120 hotel room had cost $127.20.

Or you might ask the CEO’s of the U.S. corporations that locate plants overseas if they favor low-wage countries. They do not. They’ve put more money into Germany (whose workers are paid more than Americans) than into the entire Asian continent, more into Netherlands and the UK, than into all of Latin America, six times more into tiny Switzerland than to all of Africa. The numbers show that high wages does not drive away investment.

The quality of life in Santa Fe is something we cherish, and it also attracts visitors to our city. It is based on a belief which most of us share: it is that for all our glorious (and sometimes annoying) differences, we are connected by a fabric of respect, affection, curiosity about one another, tolerance, and to some extent, a common fate. The widening differences between what our wage earners make and what other Santa Feans have may tear at the threads of this fragile fabric. I know that most Santa Feans -- business people, wage earners and others -- want to see this fabric enriched. I am confident that the members of our City Council can find a way to do it.

The author is the Director of the Economics Program at the Santa Fe Institute. He previously taught economics at Harvard and the University of Massachusetts, and was an economic advisor to Robert F. Kennedy, Martin Luther King, Nelson Mandela, and others. Sources of the information used here can be found at http://www.santafe.edu/~bowles/.

A note on sources (not to be published but to be posted on the website)

Henry Ford’s 5$ day is based on Raff (1988)


“a ten percent increase in wages results in a 2.2 percent decrease in employment.” is from
Macpherson (2003)

“Most individuals in low-wage jobs have shorter than average job duration, and little job security. Movement between jobs is frequent.” A turnover rate of 60 per cent per year in hotels was found in Wasmuth and Davis (1983). Turnover was particularly great in the low-wage jobs in food and beverage and housekeeping activities. The authors concluded that employees left because they were dissatisfied with their jobs, and particularly with their pay, not because of the pull of better job opportunities. The American Hotel Foundation’s study (Woods and Macaulay (1998)) found similar results.

“A New Orleans study...” is by three researchers at the Political Economy Research Institute, Amherst Ma, who are broadly supportive of minimum wage increases: Pollin, Brenner, and Luce (2002).

“Good wages and a good attitude are at least important for productivity as are a worker’s know-how” See for example Bowles, Gordon, and Weisskopf (1983) and Bowles, Gintis, and Osborne (2001).

The data following “ask the CEO’s of the U.S. corporations that locate plants overseas if they favor low-wage countries.” is from the U.S. Department of Commerce, Bureau of Economic Analysis at http://www.bea.doc.gov/bea/di/diacap_01.htm/.

“Widening differences between what our wage earners make and what other Santa Feans have..” is from Reynis and Sylvester (2002), figure 1.1.

References


In increase. "Employment Policies Institute: Washington, D. C.


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