

“Examining the Negative Impacts of a Minimum Wage Increase”

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Thank you for the invitation. I appreciate being invited to share insights into the impact of a significant minimum wage increase. I will briefly highlight two areas where the minimum wage has a negative impact – on workers and on businesses. Most of my report focuses on the minimum wage in general. When reading, please note that a minimum wage increase will exacerbate any issues I describe.

The impact of a minimum wage increase on workers

Demand and supply models are quite clear on what will happen with minimum wages. When there is an artificial minimum price imposed – what economists call a price floor – there will be a lower quantity exchanged in the market. Demand and supply laws therefore indicate that a minimum wage that will alter the labor market would lead to more unemployment.

Many economists have attempted to see if the findings from theory translate into actual increases in unemployment. The evidence on the literature is succinctly summarized in a January 2021 paper published by David Neumark and Peter Shirley¹. David Neumark is an authority on minimum wage research – having literally written the book on them.²

Neumark and Shirley’s paper has several key conclusions. I’m going to quote their four key findings, then provide my translation of the importance:

¹ “Myth or Measurement: What Does the New Minimum Wage Research Say about Minimum Wages and Job Loss in the United States?” <https://www.nber.org/papers/w28388>

² “Minimum Wages”. <https://mitpress.mit.edu/books/minimum-wages>

1. “There is a clear preponderance of negative estimates in the literature” and “79.3% of the estimated employment elasticities are negative”.

Translation: approximately 4 in 5 studies find the minimum wage reduces employment. You may hear many people claiming that data shows minimum wages do not increase unemployment. Those people are either cherry picking certain studies to cite or are unaware of the literature.

2. “This evidence is stronger for teens and young adults as well as the less-educated”

Translation: This might be obvious from the statement above, but job losses from a minimum wage are more concentrated among teenagers, young adults, and those with lower education levels.

3. “The evidence from studies of directly-affected workers points even more strongly to negative employment effects”

Translation: Studies that specifically examine lower wage workers find even stronger impacts. This is an important point and can help explain why only 4 in 5 studies show minimum wages reduce employment. There may be people who would choose not to work at a lower wage. For example, a college student choosing to take student loans or a parent choosing to stay home to raise children. In the event the minimum wage is increased, this subset of people may choose to work, taking jobs from those who would have accepted a lower wage. In this case, the overall unemployment rate does not change, but there is a negative impact on those who would have worked for a lower wage.

4. “The evidence from studies of low-wage industries is less one-sided ... labor-labor substitution may be important, with employers substituting away from the lowest-skilled workers and toward other workers when the minimum wage increases.”

Translation: The studies that provide the least evidence of reduced employment from a minimum wage are those that study one industry. However, when minimum wages are increased, many firms might choose not to hire the same people. For example, if the minimum wage rose from \$7.25 to \$15, it seems obvious that the entry level teenager might not be employed as a firm chooses to hire a more-experienced person. So, the low-wage

worker loses their job, and a higher-skill worker (who might have previously been out of the labor market) might take the job instead. This is labor-labor substitution and the minimum wage is having a negative impact on the low-wage worker.

The impact of a minimum wage increase on small businesses

How minimum wage increases impact businesses in general

A \$15 minimum wage will have a harmful impact on many businesses – and in particular, small businesses. First, let's state the obvious – a \$15 minimum wage will increase labor costs, driving down profitability for firms. Economic theory shows that most small businesses in competitive markets earn what are called “normal profits” or “zero economic profits” – which is just enough money to stay in business.³ Hence, a \$15 minimum wage would push profits for some firms below this level, driving some of these firms out of business.

We've seen this happen recently in California. Some grocery stores have closed down after cities in California mandated firms pay an additional \$4/hour in “hazard pay”. It is worth noting that a \$15 minimum wage would increase Pennsylvania's minimum wage by \$7.75 – almost double California's \$4 increase.

Small businesses will be harmed more than big businesses

But which firms will survive? Economic theory predicts that as wages rise, firms would hire fewer workers and attempt to have machines/technology/etc. perform those tasks. For example, many fast-food restaurants now have computerized kiosks where customers can place their orders to cut down on the number of workers they need. Amazon has been experimenting with drone delivery.⁴

Larger businesses will have an advantage over smaller businesses in this endeavor as they have economies of scale when substituting from workers to machines. For example, McDonald's franchises can get machine kiosks easily because their corporation can order thousands of units, driving down the cost. That same kiosk for a local restaurant would be more expensive, making

³ For example, see Greg Mankiw's “Principles of Economics” (2015) or just about any other economics textbook

⁴ <https://www.cnbc.com/2020/08/31/amazon-prime-now-drone-delivery-fleet-gets-faa-approval.html>

the impact of a minimum wage increase more damaging for locally owned, non-franchise restaurants.

This ability to more-easily substitute away from labor to machines could also help explain why some big-business executives – like the CEO from Amazon – are supporting minimum wage increases.⁵ A company like Amazon can automate for a lower cost than smaller businesses. A higher minimum wage could force some smaller businesses to close, ultimately meaning more customers and higher profits for Amazon.

Conclusion and Policy Recommendations

Thank you again for inviting me to comment on this important issue. To summarize, an increase in the minimum wage would:

1. Decrease employment (increase unemployment), particularly among those who work low-wage jobs.
2. Would increase costs for firms, driving some out of business.
3. Smaller, locally owned businesses will be impacted worse than bigger firms as bigger firms can more easily integrate technology to substitute away from workers. Some of these larger firms may ultimately benefit if smaller firms are forced out of business.

⁵ <https://www.businessinsider.com/amazon-vp-jay-carney-letter-support-raise-minimum-wage-2021-1>