FirstPoint Financial

WEEKLY MARKET THOUGHTS

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Too Topical to Let Pass By

Hardly a day goes by without someone in Washington making comments about the need to raise the minimum wage. Folks seem pretty free and loose to throw out historical statistics regarding the minimum wage and how entry-level workers today are being underpaid as compared to workers in the past. Commentators have added the minimum-wage issue to the income disparity discussion. Some in Washington are suggesting the minimum wage should be raised to $15 per hour, an increase of 106 percent from the current rate of $7.25 per hour. What are some of the potential ramifications on our national economy of such a wage increase? What are the facts which proponents of the wage increase are using in their arguments?

Historical "Real" Inflation Adjusted Minimum Wage

Let's take a look at some facts, all of which come from either the Bureau of Labor Statistics or the U.S. Department of Labor. Minimum wage was first initiated by the Roosevelt administration in 1938 during the period of the Great Depression. Prior to that time, workers were free (assuming the non-existence of a labor union) to bargain with their employers regarding their pay. The labor market was a more free market than at any time since.

One of the comments, which most proponents of a higher minimum wage throw out as a given, is the view that minimum wage hasn't kept pace with inflation, consequently we need to raise the wage. To the right is minimum wage data from various periods in time since 1932 *with inflation adjusted current rates supplied by the Bureau of Labor Statistics:*

	Minimum Wage	Inflation Adjusted
1938	$0.25	$4.20
1950	$0.75	$7.36
1960	$1.00	$7.99
1970	$1.45	$8.84
1980	$3.10	$8.90
1990	$3.80	$6.88
2000	$5.15	$6.88
Current	$7.25	

Per this minimum wage data, if a worker had been earning the minimum wage in 1990 ($3.80 per hour) that worker's wage today needs to be $6.88 per hour based on inflation. The current minimum wage of $7.25 has outstripped inflation over the last 25 and 15 years. So, to those who state that the minimum wage hasn't kept pace with inflation, the truth in those statements depends on the beginning point of the analysis. Clearly, based on historical information (provided by the government) ***the blanket statement*** that minimum wage hasn't stayed up with inflation is false – particularly of late.

If staying up with inflation is the true goal of raising the minimum wage, the wage doesn't need to be raised by more than $1.75 per hour, to $9 per hour. Consequently, the argument that the wage needs to be raised to $15 per hour because of inflation is a non-starter.

A "Living" Wage

Those same proponents of a higher minimum wage suggest that the current minimum wage isn't a living wage. From 1938 onward, the minimum wage was never intended to represent a living wage. Historically, ***minimum wage has been used as a wage which entry level workers were paid.***

National data backs these arguments. Seventy percent of minimum-wage paid workers are part-time (1,273,000). ***Out of a workforce of more than 146 million workers, only 373,000 full-time workers are being paid minimum wage.*** This represents less than 0.3 percent of those currently with jobs. Over the years, have minimum wage rate increases stayed up with other wage rates in the country? Again, let's take a look at some facts – this time the information is provided by the St. Louis Federal Reserve and the Bureau of Labor Statistics (BLS).

Below is data pertaining to national ***per capita personal income – which shows what the average worker makes in wages (not including benefits) on an annual basis, computed as an hourly wage.*** This hourly pay level is compared to the historical minimum wage rate.

	P.I – Hourly	Min. Wage – Hourly	Min. Wage as % of P.I
1990	$9.29	$3.80	40.9%
2000	$14.42	$5.15	35.7%
2010	$18.96	$7.25	38.0%
2015	$22.65	$7.25	32.0%

The data shows, as compared to the average full-time worker, the minimum wage earner's annual wage is 32 percent of all full-time workers. How does that percentage stand in relation to long-term historical averages? Looking back over the last 26 years (since 1990) we find the following facts:

- The minimum-wage earner's hourly pay has been ***as high as 42 percent of the average personal income hourly wage level.*** If the current minimum wage was raised to 42 percent of the current personal income hourly level, the minimum wage would be $9.89 per hour – up from the current $7.25.
- The minimum-wage earner's hourly pay has been as low ***as 28.5 percent of the average personal income hourly wage level (currently at 32 percent).*** If the current minimum wage was lowered to 28.5 percent of the current personal income hourly level, the minimum wage would be $6.71 per hour – down from the current level of $7.25.
- Finally, over the last 26 years, the minimum-wage earner's hourly pay has averaged ***35.3 percent of the average personal income wage level. If the current minimum wage was raised to 35.3 percent of the current personal income hourly level, the minimum wage would be raised to $8.31 per hour – up from the current $7.25.***

If the argument to raise the minimum wage is to keep minimum wage earners up to the rest of the average national income level, ***it is conceivably plausible to raise the rate to $9.89 – based on***

26 years of historical precedence. This would represent an increase of 36.4 percent from current levels. This of course is far from the currently proposed increase to $15 per hour. A minimum wage of $15 per hour would represent a level of 66 percent of the national average compensation level – a level unseen in the 77 year history of the minimum wage.

If we equate a living wage to the national personal income average (it is what the average American lives on) then based on historical precedence ***the minimum wage has never come close to this level. This strengthens the argument that minimum wage is not meant to be a living wage, and never has been.***

Ramifications of a Massive Increase in the Minimum Wage

Some would suggest we shouldn't pay attention to historical standards when thinking of the minimum-wage level. Those who propose $15 per hour obviously haven't done some simple homework as to historical standards, or they don't care to do so. What may be some of the ramifications of a minimum wage of $15 per hour?

- ***Employers are only going to hire workers who can produce more than they are paid***. If employers are in the habit of paying an employee more than they are able to produce, that employer will be out of business quickly. Think of the most marginally productive workers (young, inexperienced). While those workers may be valuable for an employer to hire at $7.25 per hour, they would probably balk at hiring the same workers at $15 per hour. ***If the minimum wage is raised to $15 per hour, I suggest youth <u>unemployment</u> would rise rather dramatically.***

Conclusion and Possible Solution

The economic justification to raise minimum wage is ripe, based on historical standard. Based on cost-of-living and pay parity to the rest of the country, economic data is present to justify raising the minimum wage to $9.89 per hour from the current $7.25 per hour. I can't find any economic reasoning, based again on 77 years of historical precedence, that would currently justify raising the minimum wage to $15 per hour. Perhaps our nation's leaders need to consider expanding the Earned Income Tax Credit. If installed, people who work would receive a government check on top of their earned income. This proposal has social merit.

In a recent editorial appearing in the *Wall Street Journal,* Warren Buffet said:

> *In my mind, the country's economic policies should have two main objectives. First, we should wish, in our rich society, for every person who is willing to work to receive income that will provide him or her a decent lifestyle. Second, any plan to do that should not distort our market system, the key element required for growth and prosperity.*
>
> *That second goal crumbles in the face of any plan to sizably increase the minimum wage. I may wish to have all jobs pay at least $15 per hour. But that minimum would almost certainly reduce employment in a major way, crushing many workers possessing only basic skills. Smaller increases, though obviously welcome, will still leave many hardworking Americans mired in poverty.*
>
> *The better answer is a major and carefully crafted expansion of the Earned Income Tax Credit (EITC), which currently goes to millions of low-income workers…the process is simple: You file a tax return, and the government sends you a check.*

We will be back next week.

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