

A PUBLIC CHOICE VIEW OF THE MINIMUM WAGE

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Why, when the economist gives advice to his society, is he so often coolly ignored? He never ceases to preach free trade . . . and protectionism is growing in the United States. He deplores the perverse effects of minimum wage laws, and the legal minimum is regularly raised each 3 or 5 years. He brands usury laws as a medieval superstition, but no state hurries to repeal its law.

—George Stigler

I. Introduction

Much of public policy is allegedly based on the implications of economic theory. However, economic analysis of government policy is often disregarded for political reasons. The minimum wage law is one such example. Every politician openly deplores the spectacle of double-digit teenage unemployment pervading modern society. But, when economists claim that scientific proof, a priori and empirical, dictates that minimum wage laws cause such a regretful outcome, their statements generally fall on deaf congressional ears. Economists too often assume that policymakers are interested in obtaining all the existing economic knowledge before deciding on a specific policy course. This view of the policy-formation process, however, is naive. In framing economic policy politicians will pay some attention to economists' advice, but such advice always will be rejected when it conflicts with the political reality of winning votes. At bottom, what is important in analyzing the course of economic policy is an understanding of the public choice aspects of the decision-making

Cato Journal, Vol. 5, No. 1 (Spring/Summer 1985). Copyright © Cato Institute. All rights reserved.

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process in government. In such an undertaking, the incentive structure confronting governmental decision makers must be carefully examined.

This paper therefore takes a public-choice perspective of minimum wage laws, explaining their persistent political support by examining the underlying incentive structure. Although the unemployment effects of such laws have been public knowledge for decades, and despite nearly unanimous opposition to them within the economics profession, they are now as solidly in place as ever before. Some conflicting conclusions can be drawn from this paradox: (1) the majority of economists are completely wrong on this issue, and have been for decades; or (2) politicians who claim opposition to unemployment and then call on economists to testify about the minimum wage before voting to increase it are not really interested in what economists have to say; or (3) economists have not been able to convince the average voter that it is in his interest to reject the minimum wage.

If the first conclusion is true, economists need to reevaluate the quality of their evidence on the economic effects of the minimum wage. The second conclusion would indicate that economists have very little influence over the direction of public policy disputes in advising politicians, who are constrained by the incentive structure of the "political market." The final reason for the paradox would point to a needed change in the direction of emphasis taken by economists in dealing with the minimum wage.

The relevant question for this paper, therefore, is the following: If the minimum wage law has consequences deemed undesirable by those who implement it, and if evidence accumulated over the decades conclusively proves these consequences to be inevitable features of the law, then why does it continue to survive? To answer this question, the paper begins with an examination of the economic effects of the minimum wage in section II. The sources of political support for the minimum wage law are then explored in section III. Section IV looks at the minimum wage issue from a North-South perspective and discusses the beneficiaries and victims of the minimum wage. Given the political environment of past minimum wage legislation, section V considers the prospects of real reform, and section VI concludes with the proviso that economists ought to direct their reform efforts at educating the public on the adverse effects of the minimum wage rather than trying to influence legislators directly.

II. Economic Effects of the Minimum Wage

Economic analysis has demonstrated few things as clearly as the effects of the minimum wage law. It is well known that the minimum

wage creates unemployment among the least skilled workers by raising wage rates above free market levels. Eight major effects of the minimum wage can be discussed: unemployment effects, employment effects in uncovered sectors of the economy, reduction in nonwage benefits, labor substitution effects, capital substitution effects, racial discrimination in hiring practices, human capital development, and distortion of the market process with respect to comparative advantage. Although the minimum wage has other effects, such as a reduction in hours of employment, these eight effects are the most significant ones for this paper.

Unemployment Effects

The first federal minimum wage laws were established under the provisions of the National Recovery Administration (NRA). The National Industrial Recovery Act, which became law on 16 June 1933, established industrial minimum wages for 515 classes of labor. Over 90 percent of the minimum wages were set at between 30 and 40 cents per hour.¹ Early empirical evidence attests to the unemployment effects of the minimum wage. Using the estimates of C. F. Roos, who was the director of research at the NRA, Benjamin Anderson states: "Roos estimates that, by reason of the minimum wage provisions of the codes, about 500,000 Negro workers were on relief in 1934. Roos adds that a minimum wage definitely causes the displacement of the young, inexperienced worker and the old worker."²

On 27 May 1935 the Supreme Court declared the NRA unconstitutional, burying the minimum wage codes with it. The minimum wage law reappeared at a later date, however, with the support of the Supreme Court. In what became the precedent for the constitutionality of future minimum wage legislation, the Court upheld the Washington State minimum wage law on 29 March 1937 in *West Coast Hotel v. Parrish*.³ This declaration gave the Roosevelt administration and Labor Secretary Frances Perkins the green light to reestablish the federal minimum wage, which was achieved on 25 June 1938 when President Roosevelt signed into law the Fair Labor Standards Act (FLSA).

The FLSA included legislation affecting work-age requirements, the length of the workweek, pay rates for overtime work, as well as

¹Leverett Lyon, et al. *The National Recovery Administration: An Analysis and Appraisal* (New York: Da Capo Press, 1972), pp. 318–19.

²Benjamin M. Anderson, *Economics and the Public Welfare: A Financial and Economic History of the United States, 1914–1946* (Indianapolis: Liberty Press, 1979), p. 336.

³Jonathan Grossman, "Fair Labor Standards Act of 1938: Maximum Struggle for a Minimum Wage," *Monthly Labor Review* 101 (June 1978): 23.

the national minimum wage provision. The law established minimum wage rates of 25 cents per hour the first year, 30 cents per hour for the next six years, and 40 cents per hour after seven years. The penalty for noncompliance was severe: violators faced a \$10,000 fine, six months imprisonment, or both. In addition, an aggrieved employee could sue his employer for twice the difference between the statutory wage rate and his actual pay.⁴

With the passage of the FLSA, it became inevitable that major dislocations would result in labor markets, primarily those for low-skilled and low-wage workers. Although the act affected occupations covering only one-fifth of the labor force,⁵ leaving a large uncovered sector to minimize the disemployment effects, the minimum wage was still extremely counterproductive. The Labor Department admitted that the new minimum wage had a disemployment effect, and one historian sympathetic to the minimum wage was forced to concede that "[t]he Department of Labor estimated that the 25-cents-an-hour minimum wage caused about 30,000 to 50,000 to lose their job. About 90% of these were in southern industries such as bagging, pecan shelling, and tobacco stemming."⁶

These estimates seriously understate the actual magnitude of the damage. Since only 300,000 workers received an increase as a result of the minimum wage,⁷ estimates of 30,000–50,000 lost jobs reveal that 10–13 percent of those covered by the law lost their jobs. But it is highly dubious that only 30,000–50,000 low-wage earners lost their jobs in the entire country; that many unemployed could have been found in the state of Texas alone, where labor authorities saw devastation wrought via the minimum wage on the pecan trade. The *New York Times* reported the following on 24 October 1938:

Information received today by State labor authorities indicated that more than 40,000 employees of the pecan nut shelling plants in Texas would be thrown out of work tomorrow by the closing down of that industry, due to the new Wages and Hours Law. In San Antonio, sixty plants, employing ten thousand men and women, mostly Mexicans, will close. . . . Plant owners assert that they cannot remain in business and pay the minimum wage of 25 cents an hour with a maximum working week of forty-four hours. Many garment factories in Texas will also close.⁸

⁴"Wage and Hours Law," *New York Times*, 24 October 1938, p. 2.

⁵Grossman, "Fair Labor Standards Act," p. 29.

⁶*Ibid.*, p. 28.

⁷*Ibid.*, p. 29.

⁸"Report 40,000 Jobs Lost," *New York Times*, 24 October 1938, p. 2.

It can reasonably be deduced that even if the Texas estimates had been wildly inaccurate, the national unemployment effect would still have exceeded the Department of Labor's estimates.

The greatest damage, however, did not come in Texas or in any other southern state, but in Puerto Rico. Since a minimum wage law has its greatest unemployment effect on low-wage earners, and since larger proportions of workers in poorer regions such as Puerto Rico tend to be at the lower end of the wage scale, Puerto Rico was disproportionately hard-hit. Subject to the same national 25-cents-per-hour rate as workers on the mainland, Puerto Rican workers suffered much more hardship from the minimum wage law. According to Anderson:

It was thought by many that, in the first year, the provision would not affect many industries outside the South, though the framers of the law apparently forgot about Puerto Rico, and very grave disturbances came in that island. . . . Immense unemployment resulted there through sheer inability of important industries to pay the 25 cents an hour.⁹

Simon Rottenberg likewise points out the tragic position in which Puerto Rico was placed by the enactment of the minimum wage:

When the Congress established a minimum wage of 25 cents per hour in 1938, the average hourly wage in the U.S. was 62.7 cents. . . . It resulted in a mandatory increase for only some 300,000 workers out of a labor force of more than 54 million. In Puerto Rico, in contrast . . . the new Federal minimum far exceeded the prevailing average hourly wage of the major portion of Puerto Rican workers. If a continuing serious attempt at enforcement . . . had been made, it would have meant literal economic chaos for the island's economy.¹⁰

On 24 October 1938, a special cable from Puerto Rico was printed in the *New York Times* detailing the effects of the new wage law on Puerto Rican workers:

Wage payrolls estimated at approximately \$1,000,000 monthly by the Chamber of Commerce will end tomorrow with the application of the Fair Labor Standards Act. Both labor and employers appear to be united in the position that the law applied to Puerto Rico ends employment for approximately 120,000 persons. It is also believed to terminate prospects for any possible further industrialization.

Recent conferences in Washington between Administrator Elmer F. Andrews and island representatives led to the conclusion that

⁹Anderson, *Economics and the Public Welfare*, p. 458.

¹⁰Simon Rottenberg, "Minimum Wages in Puerto Rico," in *Economics of Legal Minimum Wages*, edited by Simon Rottenberg (Washington, D.C.: American Enterprise Institute, 1981), p. 330.

there was not any means of modifying the effects of the law in the island short of a Congressional amendment. With the unemployment resulting from the law's enforcement, the Chamber of Commerce study shows that the 230,000 normally unemployed, out of a total of 650,000 employables there, will be increased to 350,000, or more than half of Labor's ranks in the island. . . .

Much of labor is more than anxious to continue at the prevailing rates on the theory that half a loaf is better than none. Labor Commissioner Prudenceo Rivera Martinez, in a published statement today said: "The medicine is too strong for the patient."¹¹

Puerto Rico's unemployment rate rose sharply due to the Fair Labor Standards Act. Tens of thousands lost their jobs in such industries as cigar and cigarette manufacturing, which all but disappeared.¹² The needlework industry, which employed over 40,000 workers in 1935, stagnated after the new act took effect. The value of needle-trade exports fell from over \$20 million before the act in 1937 to barely \$5 million in 1940.¹³ Rafael Pico describes the plight of the needlework industry after the act took effect:

An industry which had been paying three or four cents per hour for work in homes could obviously not survive under the drastic mandatory increase. The effects of the law . . . were catastrophic. . . . The industry would have disappeared entirely if a legislative appeal for special legislation on minimum wages had not been sent to the Congress of the U.S.¹⁴

After two years of economic disruption in Puerto Rico, Congress amended the minimum wage provisions.¹⁵ The minimum wage was reduced to 12.5 cents per hour, but it was too late for many industries and for thousands of low-wage earners employed by them, who suddenly found unemployment the price they had to pay for the minimum wage.

In sum, the tragedy of the minimum wage laws during the NRA and the FLSA was not just textbook-theorizing by academic economists, but real-world disaster for the thousands who became the victims of the law. But these destructive effects have not caused the law to be repealed; to the contrary, it has been expanded in coverage and increased in amount.

¹¹"Puerto Rico Hurt by Wage Hour Law," *New York Times*, 24 October 1938, p. 2.

¹²Rafael Pico, *The Geography of Puerto Rico* (Chicago: Aldine Publishing, 1974), p. 293.

¹³*Ibid.*, p. 294.

¹⁴*Ibid.*

¹⁵Rottenberg, "Minimum Wages in Puerto Rico," p. 333.

Meanwhile, as can be seen from Table 1, the evidence for the unemployment effects of the minimum wage continues to mount. Many empirical studies since the early 1950s—from early research by Marshall Colberg and Yale Brozen to more recent work by Jacob Mincer and James Ragan—have validated the predictions of economic theory regarding the unemployment effects of the minimum wage law. In virtually every case it was found that the net employment effects and labor-force participation rates were negatively related to changes in the minimum wage. In the face of 50 years of evidence, the question is no longer *if* the minimum wage law creates unemployment, but *how much* current or future increases in the minimum wage will adversely affect the labor market.

Employment in Uncovered Sectors

The labor market can be divided into two sectors: that covered by the minimum wage law, and that not covered. In a partially covered market, the effects of the minimum wage are somewhat disguised. Increasing it disemploys workers in the covered sector, prompting them to search for work in the uncovered sector if they are trainable and mobile. This then drives down the wage rate in the uncovered sector, making it lower than it otherwise would have been. Since perfect knowledge and flexibility is not observed in real-world labor markets, substantial unemployment can occur during the transition period.

Employees in the covered sector who do not lose their jobs get a wage-rate increase through the higher minimum wage. But this comes only at the expense of (1) the disemployed workers who lose their jobs and suffer unemployment during the transition to employment in the uncovered sector, and (2) everyone in the uncovered sector, as their wage rate falls due to the influx of unemployed workers from the covered sector. While increasing the incomes of some low-wage earners, increasing the minimum wage tends to make the lowest wage earners in the uncovered sector even poorer than they otherwise would have been.

Yale Brozen has found that the uncovered household sector served to absorb the minimum wage-induced disemployed in the past.¹⁶ But the “safety valve” of the uncovered portion of the economy is rapidly vanishing with the continual elimination of various

¹⁶Yale Brozen, “Minimum Wage Rates and Household Workers,” *Journal of Law and Economics* 5 (October 1962): 103–10.

TABLE 1
UNEMPLOYMENT EFFECTS OF THE MINIMUM WAGE: A SURVEY

Author(s)	Source	Empirical Findings & Conclusions
Marshall Colberg	"Minimum Wage Effects on Florida's Economic Development," <i>Journal of Law and Economics</i> (October 1962)	The response to the increase in the minimum wage from \$0.75 per hour to \$1.00 per hour resulted in a 15.2 percent reduction in man-hours of employment for production workers in low-wage counties during January–April 1956. Weeks of unemployment compensation paid for low-wage counties increased 67.8 percent during the same period.
Yale Brozen	"Minimum Wage Rates and Household Workers," <i>Journal of Law and Economics</i> (April 1962)	Household employment, which usually moves contracyclically, failed to do so when the minimum wage was increased. The uncovered sector of the household labor market absorbed those workers who became displaced by the higher minimum wage.
Arthur Burns	<i>The Management of Prosperity</i> (New York: Columbia University Press, 1966)	An increase of \$0.25 per hour in the minimum wage would raise the unemployment rate for nonwhite teenagers by 8 percent.
Yale Brozen	"The Effects of the Statutory Minimum Wage Increases on Teen-Age Unemployment," <i>Journal of Law and Economics</i> (April 1969)	Successive increases in the minimum wage were directly followed by increases in the teenage unemployment rate.
Finis Welch	"Minimum Wage Legislation in the United States," <i>Economic Inquiry</i> (September 1974)	The minimum wage reduced employment and heightened vulnerability of teenage employment over the course of the business cycle.

Edward Gramlich	"Impact of Minimum Wage on Other Wages, Employment, and Family Income," <i>Brookings Papers on Economic Activity</i> 2 (1976)	The minimum wage creates unemployment, while the bulk of increased benefits tend to go to higher income families.
Jacob Mincer	"Unemployment Effects of Minimum Wages," <i>Journal of Political Economy</i> (August 1976)	The net effect of the minimum wage on labor force participation is negative, with the largest negative effect observed for nonwhite teenagers. The net employment effect is also negative, with the largest disemployment occurring in the nonwhite teenage group.
U.S. Chamber of Commerce	<i>The Congressional Record</i> , 6 October 1977, p. 32708	The estimated impact of the proposed increases in the minimum wage from \$2.30 to \$3.15 in three steps through January 1980 would lead to a national 1,977,000 job loss, and a 4.1 percent increase in labor costs.
James Ragan	"Minimum Wages and the Youth Labor Market," <i>Review of Economics and Statistics</i> (May 1977)	Had the 1966 amendment to increase the minimum wage not occurred, aggregate youth employment would have been 225,000 higher in 1972, and the youth unemployment rate 3.8 percent lower.
William Beranek	"The Illegal Alien Work Force, Demand for Unskilled Labor, and the Minimum Wage," <i>Journal of Labor Research</i> (Winter 1982)	"The abolition of minimum wage laws and alternative income support programs in 1978 could have increased employment levels of domestic unskilled workers from roughly 500,000 to 2 million." ^a
Robert H. Meyer & David A. Wise	"The Effects of the Minimum Wage on the Employment and Earnings of Youth," <i>Journal of Labor Economics</i> 1, no. 1 (1983)	"Among black youth with market wage rates below the minimum, nonemployment is increased from 25.3% without the minimum to 43.4% with the minimum." ^a

^aDirect quotation from the author(s).

exemptions.¹⁷ Because of this trend we can expect to see the level of structural unemployment increase with escalation of the minimum wage.¹⁸

Nonwage Benefits

Wage rates are not the only costs associated with the employment of workers by firms. The effective labor cost a firm incurs is usually a package of pecuniary and nonpecuniary benefits. As such, contends Richard McKenzie,

employers can be expected to respond to a minimum wage law by cutting back or eliminating altogether those fringe benefits and conditions of work, like the company parties, that increase the supply of labor but which do not affect the productivity of labor. By reducing such non-money benefits of employment, the employer reduces his labor costs from what they otherwise would have been and loses nothing in the way of reduced labor productivity.”¹⁹

If one takes the view that employees desire both pecuniary and nonpecuniary income, then anything forcing them to accept another mix of benefits would clearly make them worse off. For example, suppose worker A desires his income in the form of \$3.00 per hour in wages, an air-conditioned workplace, carpeted floors, safety precautions, and stereo music. If he is *forced* by the minimum wage law to accept \$3.25 per hour and fewer nonpecuniary benefits, he is worse off than at the preminimum wage and the *higher* level of nonpecuniary income. A priori, the enactment of minimum wage laws must place the worker and employer in a less-than-optimal state. Thus it may not be the case that only unemployed workers suffer from the minimum wage; even workers who receive a higher wage and retain employment may be net losers if their nonpecuniary benefits are reduced.

Labor Substitution Effects

The economic world is characterized by a plethora of substitutes. In the labor market low-skill, low-wage earners are substitutes for high-skill, high-wage earners. As Walter Williams points out:

Suppose a fence can be produced by using either one high skilled worker or by using three low skilled workers. If the wage of high skilled workers is \$38 per day, and that of a low skilled worker is \$13 per day, the firm employs the high skilled worker because costs

¹⁷Finis Welch, “Minimum Wage Legislation in the United States,” *Economic Inquiry* 12 (September 1974): 286.

¹⁸Brozen, “Minimum Wage Rates and Household Workers,” pp. 107–08.

¹⁹Richard McKenzie, “The Labor Market Effects of Minimum Wage Laws: A New Perspective,” *Journal of Labor Research* 1 (Fall 1980): 258–59.

would be less and profits higher (\$38 versus \$39). The high skilled worker would soon recognize that one of the ways to increase his wealth would be to advocate a minimum wage of, say, \$20 per day in the fencing industry. . . . After enactment of the minimum wage laws, the high skilled worker can now demand any wage up to \$60 per day . . . and retain employment. Prior to the enactment of the minimum wage of \$20 per day, a demand of \$60 per day would have cost the high skilled worker his job. Thus the effect of the minimum wage is to price the high skilled worker's competition out of the market.²⁰

Labor competes against labor, not against management. Since low-skill labor competes with high-skill labor, the minimum wage works against the lower-skill, lower-paid worker in favor of higher-paid workers. Hence, the consequences of the law are exactly opposite its alleged purpose.

Capital Substitution Effects

To produce a given quantity of goods, some bundle of inputs is required. The ratio of inputs used to produce the desired output is not fixed by natural law but by the relative prices of inputs, which change continuously with new demand and supply conditions. Based on relative input prices, producers attempt to minimize costs for a given output. Since many inputs are substitutes for one another in the production process, a given output can be achieved by increasing the use of one and diminishing the use of another. The optimal mix will depend on the relative supply and demand for competing substitute inputs.

As a production input, low-skill labor is often in direct competition with highly technical machinery. A Whirlpool dishwasher can be substituted for low-skill manual dishwashers in the dishwashing process, and an automatic elevator can take the place of a nonautomatic elevator and a manual operator. This not to imply that automation "destroys jobs," a common Luddite myth. As Frederic Bastiat explained over a century ago, jobs are obstacles to be overcome.²¹ Automation shifts the *kinds* of jobs to be done in society but does not reduce their total number. Low-skill jobs are done away with, but higher-skill jobs are created simultaneously. When the minimum wage raises the cost of employing low-skill workers, it makes the substitute of automated machinery an attractive option.

²⁰Walter Williams, *The State Against Blacks* (New York: McGraw-Hill, 1982), pp. 44–45.

²¹Frederic Bastiat, *Economic Sophisms* (Irvington-on-Hudson, N.Y.: Foundation for Economic Education, 1946), pp. 16–19.

Racial Discrimination in Hiring Practices

At first glance the connection between the level of racial discrimination in hiring practices and the minimum wage may not seem evident. On closer examination, however, it is apparent that the minimum wage law gives employers strong incentives to exercise their existing racial preferences.²² The minimum wage burdens minority groups in general and minority teenagers most specifically. Although outright racism has often been blamed as the sole cause of heavy minority teenage unemployment, it is clearly not the only factor. William Keyes informs us that

In the late 1940's and early 1950's, young blacks had a lower unemployment rate than did whites of the same age group. But after the minimum wage increased significantly, especially in 1961, the black youth unemployment rate has increased to the extent that it is now a multiple of the white youth unemployment rate.²³

To make the case that racism itself is the cause of the employment and unemployment disparity among blacks and whites, one would have to claim that America was more racially harmonious in the past than it is now. In fact, during the racially hostile times of the early 1900s 71 percent of blacks over nine years of age were employed, as compared with 51 percent for whites.²⁴ The minimum wage means that employers are not free to decide among low-wage workers on the basis of price differentials; hence, they face fewer disincentives to deciding according to some other (possibly racial) criteria.

To see the racial implications of minimum wage legislation, it is helpful to look at proponents of the law in a country where racial hostility is very strong, South Africa. Since minimum wage laws share characteristics in common with equal pay laws, white racist unions in South Africa continually support both minimum wage and equal-pay-for-equal-work laws for blacks. According to Williams:

Right-wing white unions in the building trades have complained to the South African government that laws reserving skilled jobs for whites have been broken and should be abandoned in favor of equal pay for equal work laws. . . . The conservative building trades made it clear that they are not motivated by concern for black workers but had come to feel that legal job reservation had been so eroded by government exemptions that it no longer protected the white worker.²⁵

²²Walter Williams, "Government Sanctioned Restraints That Reduce the Economic Opportunities for Minorities," *Policy Review* 22 (Fall 1977): 15.

²³William Keyes, "The Minimum Wage and the Davis Bacon Act: Employment Effects on Minorities and Youth," *Journal of Labor Research* 3 (Fall 1982): 402.

²⁴Williams, *State Against Blacks*, p. 41.

²⁵*Ibid.*, p. 43.

The reason white trade unions are restless in South Africa is a \$1.52-per-hour wage differential between black and white construction workers.²⁶ Although the owners of the construction firms are white, they cannot afford to restrict employment to whites when blacks are willing to work for \$1.52 per hour less. As minimum wages eliminate the wage differential, the cost to employers of hiring workers with the skin color they prefer is reduced. As the cost of discrimination falls, and with all else remaining the same, the law of demand would dictate that more discrimination in employment practices will occur.

Markets frequently respond where they can, even to the obstacles the minimum wage presents minority groups. In fact, during the NRA blacks would frequently be advanced to the higher rank of "executives" in order to receive exemptions from the minimum wage.²⁷ The free market demands that firms remain color-blind in the conduct of business: profit, not racial preference, is the primary concern of the profit-maximizing firm. Those firms who fail the profit test get driven out of business by those who put prejudice aside to maximize profits. When markets are restricted by such laws as the minimum wage, the prospects for eliminating racial discrimination in hiring practices and the shocking 40–50 percent rate of black teenage unemployment in our cities are bleak.

Human Capital Development

Minimum wage laws restrict the employment of low-skill workers when the wage rate exceeds the workers' marginal productivity. By doing so, the law prevents workers with the least skills from acquiring the marketable skills necessary for increasing their future productivity, that is, it keeps them from receiving on-the-job training.

It is an observable fact, true across ethnic groups, that income rises with age.²⁸ As human capital accumulates over time, it makes teenagers more valuable to employers than workers with no labor-market experience. But when teenagers are priced out of the labor market by the minimum wage, they lose their first and most crucial opportunity to accumulate the human capital that would make them more valuable to future employers. This stunting reduces their lifetime potential earnings. As Martin Feldstein has commented:

[F]or the disadvantaged young worker, with few skills and below average education, producing enough to earn the minimum wage

²⁶Ibid., pp. 43–44.

²⁷Lyon, *National Recovery Administration*, p. 339.

²⁸U.S., Department of Commerce, Bureau of the Census, *Statistical Abstract of the United States 1982–83*, p. 431.

is incompatible with the opportunity for adequate on-the-job learning. For this group, the minimum wage implies high short-run unemployment and the chronic poverty of a life of low wage jobs.²⁹

Feldstein also finds a significant irony in the minimum wage: "It is unfortunate and ironic that we encourage and subsidize expenditure on formal education while blocking the opportunity for individuals to 'buy' on-the-job training."³⁰ This is especially hard on teenagers from the poorest minority groups, such as blacks and hispanics—a truly sad state of affairs, since the law is instituted in the name of the poor.

Distortion of the Market Process

Relative prices provide the transmission mechanism by which information is delivered to participants in the market about the underlying relative scarcities of competing factor inputs. They serve as signals for people to substitute relatively less scarce resources for relatively more scarce resources, in many cases without their even being aware of it.³¹

Whenever relative price differentials exist for input substitutes in the production process, entrepreneurs will switch from higher-priced inputs to lower-priced inputs. In a dynamically changing economy, this switching occurs continually. But when prices are not allowed to transmit market information accurately, as in the case of prices artificially controlled by government, then distorted information skews the market and guides it to something clearly less than optimal.³²

Minimum wages, being such a distortion of the price system, lead to the wrong factor input mix between labor and all other inputs. As a result, industry migrates to locations of greater labor supply more slowly, and labor-intensive industries tend to remain fixed in non-optimal areas, areas with greater labor scarcity. Large labor pools of labor-abundant geographical areas are not tapped because the controlled price of labor conveys the wrong information to all the parties involved. Thus, the existence of price differentials, as knowledge to be transmitted through relative prices, is hidden.³³ The slowdown of industrial migration keeps labor-abundant regions poorer than they otherwise would be because economic growth there is stifled. As

²⁹Martin Feldstein, "The Economics of the New Unemployment," *The Public Interest*, no. 33 (Fall 1973): 14–15.

³⁰*Ibid.*, p. 15.

³¹Thomas Sowell, *Knowledge and Decisions* (New York: Basic Books, 1980), p. 79.

³²*Ibid.*

³³*Ibid.*, pp. 167–68.

Simon Rottenberg explains for the case of Puerto Rico:

The aggregate effect of all these distortions was that Puerto Rico could be expected to produce fewer goods and services than would have otherwise been produced and that the rate at which insular per capita income rose toward mainland United States income standards could be expected to be dampened. In sum, the minimum wage law could be expected to reduce the rate of improvement in the standard of life of the Puerto Rican people and to intensify poverty in the island.³⁴

In summary, the evidence is in on the minimum wage. All eight major effects of the minimum wage examined here make the poor, disadvantaged, or young in society worse off—the alleged beneficiaries turn out to be the law's major victims. So why does a law whose consequences its own designers would officially declare to be "bad" on all counts continue to survive decade after decade? Why, moreover, is it periodically expanded in scope and raised in amount? The answer is to be found by examining the actual beneficiaries of the law and the functioning of the political market.

III. Sources of Political Support for the Minimum Wage

Unions and the Minimum Wage

Unions everywhere support the minimum wage, a fact that could be deduced from the above analysis of the labor substitution effect of the minimum wage law. Unions are labor cartels that attempt to restrict the supply of workers entering given occupations. Since non-union labor is priced below the cartelized price of union labor, it is an attractive substitute for union workers. Because unionization of *all* potential competition to the cartel is impossible due to the high policing costs that would be involved, unions resort to the minimum wage. By artificially increasing the wage rate of lower-skilled workers—who could substitute for union workers—the minimum wage increases the demand for union workers and hence their wage rates. Thus, government enforcement of a minimum wage allows unions to (1) keep a stronger cartel, raising their income; (2) incur no policing costs; and (3) have the government force low-skilled, nonunion workers out of the labor market.

It is important to note that unions unanimously supported the cartelization created by the NRA codes.³⁵ When the NRA and the minimum wage provisions were abolished in 1935 by the Supreme

³⁴Rottenberg, "Minimum Wages in Puerto Rico," p. 329.

³⁵Jesse Thomas Carpenter, *Competition and Collective Bargaining in the Needle Trades 1910–1967* (New York: W. F. Humphrey Press, 1972), p. 759.

Court, unions scurried to reestablish wage floors everywhere. The recurrent phenomenon of firms with lower labor costs outcompeting unionized firms presented a serious problem for such labor unions as the International Ladies Garment Workers Union, which faced its fiercest competition from nonunion garment factories in the southern United States and in Puerto Rico. The efforts of major unions to equalize labor costs nationally were futile.³⁶ A substitute for the defunct NRA codes was needed by the unions and was found in the Fair Labor Standards Act. Former senator Paul Douglas notes the support of the FLSA by prominent union leaders:

Sidney Hillman, president of the Amalgamated Clothing Workers, an important CIO union, who was in charge of the organization drive in the textile industry, testified, however, that he wanted this power of the Board retained, since he believed that legislation should not stop at an \$800 full-time yearly wage. He, moreover, declared that such higher rates would aid rather than hinder collective bargaining by protecting the high wage firms from undue wage-cutting by competitors.³⁷

On 19 July 1955, testimony was entered in the *Congressional Record* from the presidents of four major unions concerning the minimum wage in Puerto Rico. The union presidents demanded that the Puerto Rican minimum be increased in spite of the opposition of Governor Luis Munoz-Marin.³⁸ It is just not credible that the presidents of the Amalgamated Clothing Workers, International Ladies Garment Workers Union, United Hatters, Cap and Millinery Workers, and the Textile Workers Union were all sincerely misguided humanitarians who happened not to understand the economic effects of the law. To the contrary, they knew that Puerto Rican wage differentials spelled trouble for members of their unions.

The question of the minimum wages to be required in Puerto Rico under the act is of special interest to the four unions [the four unions mentioned above], which have formed the Joint Minimum Wage Committee. . . . Yet, today, the wage gap between Puerto Rico and the mainland is wider, not narrower, than it was in 1949, and Puerto Rico enjoys greater, not less, competitive advantages over the mainland. . . . The lack of proper wage advances in Puerto Rico constitutes an increasingly unfair threat to the mainland. This is a situation which cannot be left unchallenged by your committee and the House of Representatives.³⁹

³⁶Ibid., p. 815.

³⁷Paul Douglas, "Fair Labor Standards Act of 1938," *Political Science Quarterly* 53 (December 1938): 501.

³⁸*Congressional Record*, 19 July 1955, p. 10977.

³⁹Ibid.

In what must go down in history as a classic example of political double-talk, the union presidents said that "[t]he unions joining in this communication are all friends of Puerto Rico. If we were unconcerned about the island's economic welfare we would be urging uniform minimum wages for Puerto Rico and the mainland."⁴⁰

The union presidents were declaring explicitly that they understood the economic effects of the law. They also understood their self-interest, however, and therefore denounced the wage differentials. What is so astounding is that they would first express their knowledge that elimination of the wage differential would harm the island, then demand an increase in the minimum wage, and then claim to be friends of Puerto Rico! Rottenberg sums up the unions' motivation in getting the law applied to Puerto Rico:

It is clear that their intention is not to improve the conditions of Puerto Rican workers so much as to deprive those workers of employment opportunities by compelling them to offer their services at a high legally defined price. Their interest lies in influencing the spatial distribution of particular kinds of economic activity so that more of the kinds of goods produced by their members will be made on the mainland and less in Puerto Rico. They want to effect the distribution of wealth and income to the advantage of particular sets of mainland workers at the expense of Puerto Rican workers. The minimum wage law is an instrumental tactic employed by unions to achieve that purpose.⁴¹

Trade unions are highly organized institutions, and they do not take lightly the benefits that accrue to them through minimum wage laws. At their disposal are large numbers of highly organized voting members, as well as considerable financial/political clout.⁴² Five of the ten largest political action committees in 1979–80 were unions.⁴³ The greatest concentration of benefits would, a priori, be thought to accrue to unions in such occupations as apparel, textiles, and agriculture, where direct competition with nonunion workers is greatest. And indeed, these are the unions we actually see consistently lobbying for higher minimum wages.

It is clear that unions have no intention of improving the lot of poorer workers through the minimum wage law, especially those in Puerto Rico and the Virgin Islands. Since there are no official trade barriers between U.S. territories and the mainland, the minimum

⁴⁰Ibid.

⁴¹Rottenberg, "Minimum Wages in Puerto Rico," p. 337.

⁴²Norman J. Ornstein, et al., *Vital Statistics of Congress 1982* (Washington, D.C.: American Enterprise Institute, 1982), p. 77.

⁴³Ibid., p. 86.

wage serves as a proxy for tariffs on goods imported from lower-wage territories. It is hard to believe that the supposedly benign intentions of unions are usually accepted at face value. Equally amazing is the fact that the alleged motives of a second major beneficiary, business, are also uncritically accepted.

Business Support for the Minimum Wage

At first glance it may seem strange that business would push for a higher minimum wage. On examination, however, we find that some businesses have the same motives for supporting the minimum wage as have labor unions. The economic self-interest of businesses that pay above the minimum wage dictates that they try to eliminate lower-cost rivals that pay below the minimum by forcing them to pay higher wage rates. That this is the case can be seen as far back as the time of the NRA codes.

Business interest groups definitely favored the minimum wage and price fixing of the NRA. In April 1935 the U.S. Chamber of Congress voted 1,495 to 419 in favor of continuation of the NRA.⁴⁴ After the Supreme Court declared the NRA unconstitutional, businesses collaborated with unions in lobbying for a substitute. The letter of C. R. Palmer, president of Cluett, Peabody and Co., to Rep. Arthur Healy (Mass.) on 25 March 1938 speaks for itself:

When the present administration went into office, we wrote the Department of Labor, March 21, 1938, requesting that consideration be given to the possibility of establishing a minimum wage throughout the country. We realized that in many sections of the country wages were so low and hours so long that it made it impossible, or most difficult, to obtain business by companies that were paying good wages and working reasonable hours. So, when the N.R.A. provisions for wages and hours were adopted, we believed that objective had been obtained. Then when the N.R.A. collapsed, we were glad that many companies did not immediately increase their hours or reduce their wages. But now the situation is again difficult. . . . We had hopes that there would be a new bill controlling this situation within reasonable limits. . . . We are hoping that you agree with us, and that you will use your influence to see that something is done about it.⁴⁵

Three months later, President Roosevelt signed the Fair Labor Standards Act into law.

When proposals to raise the minimum wage in the 1950s materialized, businesses were at the forefront of the lobbying effort. On 19

⁴⁴Carpenter, *Competition and Collective Bargaining*, p. 759.

⁴⁵*Congressional Record*, 28 March 1938, p. 1213.

July 1955, Representative Reuss from Milwaukee entered the following in the *Congressional Record*:

I am proud of the fact that employers from my district have written me asking my support for the \$1.25 minimum wage because they do not want sweatshop competition. Some of these letters from Milwaukee employers show a high level of social responsibility and business morality which I wish to quote for the Record:

Dear Congressman Reuss:

This is to advise you that the Schmitt-Orlon Co. subscribes to the \$1.25 minimum wage, as it will serve to bring closer the wage differentials between the low and high labor areas. . . .

We, Wisconsin textile garment manufacturers, would then be placed on a better competitive basis.

Yours very truly,

Arthur J. Schmitt,

Chairman of the Board.⁴⁶

Businesses like the minimum wage for the same reason they like tariffs—to shut out lower-priced firms from free market competition. The minimum wage becomes a mechanism by which firms with high labor costs can force higher labor costs on their lower-cost competition. What makes it so seductive for businesses is that it can effectively close down their rivals, increase their incomes, and enable them to claim “social responsibility and business morality” in the process.

The Poverty Industry

The tragedy of the minimum wage is not only the 40–50 percent black teenage unemployment rates in our large cities, but that many drop out of the labor force altogether to become another poverty statistic or turn to criminal activity. If frustrated workers can end up as recipients of the generous welfare state, they may decide that receiving welfare is better than working productively. As Keith Leffler states:

The alternative implicitly in mind for disemployed workers is zero income. However, this is unlikely to be the relevant alternative in the 1970's since public relief programs are available for nearly all categories of citizens laid off due to a higher minimum wage. Minimum wages may therefore be a technique of lowering the costs of, establishing eligibility for the increasingly generous public welfare programs.⁴⁷

⁴⁶*Congressional Record*, 19 July 1955, p. 10984.

⁴⁷Keith Leffler, “Minimum Wages, Welfare, and Wealth Transfers to the Poor,” *Journal of Law and Economics* 21 (October 1978): 346.

Examining the ratio of average income from work at the minimum wage to average income from Aid to Families with Dependent Children (AFDC) welfare payments, Leffler found that “[o]n the average, AFDC payments alone replace over 80 percent of work income. In addition, work related expenses (excluding day care) averaged over 15 percent of earned income for those with minimum-wage income levels.”⁴⁸

Although increases in welfare payments tend to draw people away from work and onto the welfare rolls, it is not true that increases in the minimum wage necessarily draw people away from welfare.⁴⁹ Linda Leighton and Jacob Mincer make an analogous observation concerning the so-called inducement hypothesis, which describes the alleged incentive effects of the minimum wage on school enrollment: “It is clear now, given the evidence on labor force participation and on enrollment effects of minimum wages, that the inducement argument is not valid. Indeed, the logical conclusion is to the contrary: minimum wages induce welfare, not work.”⁵⁰

In this case, the unemployed workers who receive welfare are not the only vested interests; social workers and the entire “poverty industry” also benefit. If there are more poor because of the minimum wage, the demand for people to manage and take care of the poor also increases.⁵¹ There is little incentive for social workers or poverty rights activists to advocate the repeal of the law that keeps them employed.

Politicians who “champion” a large poverty class are beneficiaries of the minimum wage as well. Since the law cuts off the first necessary condition for upward mobility (first-time employment), a permanent supporting constituency is preserved. A powerful triangle then emerges among the “poverty politician,” social workers, and welfare recipients. Politicians who claim to represent the working poor can raise the minimum wage, throwing low-wage earners out of work. The modern welfare state can pick them up and provide them with greater benefits than what they could receive by working. Welfare recipients reward the politicians by voting for them, and the social workers and welfare bureaucrats find the demand for their services increased, entrenching their jobs. Each group in the political triangle of the

⁴⁸Ibid., pp. 353–54.

⁴⁹Ibid., p. 350.

⁵⁰Linda Leighton and Jacob Mincer, “The Effects of Minimum Wages on Human Capital Formation,” in Rottenberg, *Economics of Legal Minimum Wages*, p. 157.

⁵¹Walter Williams, “Economist Addresses Racial and Economic Fallacies,” *Laissez-Faire Society*, 11 April 1984, p. 2.

minimum wage tends to benefit at the expense of the general taxpayer and the relatively low-skilled worker.

IV. Beneficiaries and Victims of the Minimum Wage: A North-South Perspective

The beneficiaries and victims of the minimum wage are clearly visible when the historical attitudes of the Northern and Southern United States are compared. The North, tending to have higher wage rates due to earlier industrialization, would be the net beneficiary; the South, with lower wage rates, would be the major loser.

With the creation of the NRA, the United States had for the first time a national law for minimum wages. The minimum wage provisions of the NRA were not unified into a single wage for all classes of industrial labor; some were set differently.⁵² Industries located in high-wage districts, in this case the North in general, desired an absence of wage differentials during the process of code formation.⁵³

It has already been established that the minimum wage imposed by the NRA devastated the South and Puerto Rico. Benjamin Anderson summarizes the consequences of the NRA in the following observation:

NRA created a great deal of unemployment in the South. Despite the differentials, the greatest percentage increase in wages, the greatest shortening of hours, and the greatest percentage increase in labor costs under NRA were in the South. In the lumber trade, for example, very little increase was made in western wages, while a very great increase was made in southern wages, even though they remained well below those of the West. . . . An interesting book by Charles Frederick Roos . . . gives significant figures in connection with this point and says: "In view of these data, it is not surprising that lumber business was diverted from the South to the Pacific Northwest."⁵⁴

With the demise of the NRA, textile, apparel, lumber, and other industrial sectors began to experience vigorous competition from the South. This occurred because geographical wage differentials reappeared, reflecting underlying free market comparative advantages of doing business in the South. Consequently, Northern unions (such as the International Ladies Garment Workers Union) and industrial associations (such as the National Dress Manufacturers Association)

⁵²Lyon, *National Recovery Administration*, p. 317.

⁵³Ibid, p. 324.

⁵⁴Anderson, *Economics and the Public Welfare*, p. 336.

desired the protection of Northern industry.⁵⁵ During the period before the enactment of the FLSA, both unions and businesses in the North had begun to express a fear of Southern competition.⁵⁶

In the needle trades, it became evident that the wage rates set by the NRA would not hold. Manufacturing associations attempted to re-create the NRA privately and failed completely, largely due to enforcement failures.⁵⁷ Such unions as the Amalgamated Clothing Workers of America attempted general organization drives with special emphasis on the South but also met with widespread failure.⁵⁸ Faced with these failures in attempting private cartelization to protect Northern from Southern industry, government cartelization became the logical alternative. This form of cartelization came in the form of the FLSA, as noted by Walter Boles: "There is evidence to show that some of the support behind the Act—a consequence of the interstate nature of markets—was based on the older industrial areas' fear of the growing industrialization of the South."⁵⁹

The political-geographical background of the FLSA became sharply distinct. Northern senators and congressmen lined up to support the act, while representatives from the South opposed it. John F. Moloney observes that

The elimination of so-called "unfair competition" and of regional wage differentials was also a factor of some importance. The lower wage structure of the South received its fair share of attention during the debates in Congress.⁶⁰

Since businesses that pay above the minimum wage urge higher minimums on their competition, and since firms in the Northern United States tended to incur higher labor costs than their Southern counterparts, it is only logical that Northern firms would have pressed for passage of the FLSA. Paul Douglas states:

So far as the employers were concerned, the northern textile industry was definitely in favor of the bill, and opposed to the granting of any regional differentials. It welcomed a national scale as a means of protecting themselves against southern competition with lower wages.⁶¹

⁵⁵Carpenter, *Competition and Collective Bargaining*, pp. 812–13.

⁵⁶*Congressional Record*, 28 March 1938, p. 1213.

⁵⁷Carpenter, *Competition and Collective Bargaining*, p. 815.

⁵⁸*Ibid.*

⁵⁹Walter Boles, "Some Aspects of the Fair Labor Standards Act," *Southern Economic Journal* 6 (April 1940): 498–99.

⁶⁰John F. Moloney, "Some Effects of the Fair Labor Standards Act Upon Southern Industry," *Southern Economic Journal* 8 (July 1942): 15.

⁶¹Douglas, "Fair Labor Standards Act," p. 501.

According to Senator Walsh (Mass.), the new minimum wage was to provide protection for Northern industry:

Industries in New England that now operate on a forty hour week . . . and pay reasonable minimum wages will not continue to be subject to competition in the trade markets with goods produced by industries that can undersell New England producers due to the fact that they are working their employees longer hours and paying lower wages."⁶²

A telegram sent to Representative Healey from Governor Charles F. Hurley of Massachusetts demonstrates the fact that the FLSA was favored in the North because of the protection it afforded. The telegram did not hide the fact that the law was in the interests of this particular Northern state.

We here in Massachusetts are deeply interested in having the pending wage and hour bill adopted by Congress during this session. As a Massachusetts Congressman I am sure you realize how important it is for such Federal legislation to be adopted and for Massachusetts to have equal competition with other sections of the country, thus affording labor and industry of Massachusetts some degree of assurance that our present industries will not move out of the State.⁶³

And on 6 April 1938, Rep. John F. Dockweiler (Calif.) openly admitted that he could not think of a single trade or industry in his state where the prevailing minimum wage was not considerably higher than the 30 cents per hour proposed in the FLSA.⁶⁴ Of course, he then went on to throw his unbending support for its passage. On 4 May 1938, Rep. Robert Allen (Penn.) introduced in the *Congressional Record* a radio address of Representative Healey from the previous day. Healey's comments again show his concern for Massachusetts:

Sweatshops and low-wage areas have grown like mushrooms in all sections of the country. . . . They have . . . undermined decent industry by ruinous competition, snatched away markets, lured factories out of high-standard areas. . . .

. . . Massachusettes, long preeminent in the manufacture of textiles, has seen its commanding position swept away by the corrosive competition of sweated industries. Between 1923 and 1933, the New England textile industry lost nearly 120,000 jobs, mostly from Massachusettes. One hundred and twenty thousand jobs were taken out of that industrial region, principally because of low wages elsewhere. . . .⁶⁵

⁶²Ibid.

⁶³*Congressional Record*, 3 May 1938, p. 1800.

⁶⁴*Congressional Record*, 6 April 1938, p. 1353.

⁶⁵*Congressional Record*, 4 May 1938, pp. 1840–41.

We find congressmen from Indiana making similar statements:

There are in the state of Georgia, canning factories working . . . women 10 hours a day for [\$]4.50 a week. Can the canning factories of Indiana and Connecticut or New York continue to exist and meet such competitive labor costs?⁶⁶

A common explanation for the passage of the FLSA—the protection of the helpless working poor—is blatantly deficient in that it completely ignores the geopolitical struggle that pervaded the issues.⁶⁷ The driving force behind the establishment of the minimum wage was Northern unions and businesses. They lobbied hard for the law and were successful.⁶⁸ To the delight of such unions as the International Ladies Garment Workers Union and the Amalgamated Clothing Workers of America, the law completely destroyed the Puerto Rican needle trades. Owners of Northern textile firms who watched the government drive their competition out of business expressed little regret at that outcome.

Henry Simons demonstrated keen perception of the entire minimum wage issue some years later when he declared:

Southern workers may be intrigued by the wage expectations held out by organizers from northern unions and by the Fair Labor Standards Act. They may in a few cases get such wages, but it will be only in spite of the intentions of the northern unions and Massachusetts senators.⁶⁹

The objections raised by Southern congressmen that the minimum wage was detrimental to the economy of the South were always conveniently pushed aside by politicians representing the North. In January 1954, Sen. John F. Kennedy published an article entitled “New England and the South: The Struggle for Industry” in the *Atlantic Monthly*. In that article Senator Kennedy made clear his belief that raising the minimum wage would help stem the migration of industry from Massachusetts to Southern states such as Mississippi:

But the final reason for migration, with which I am particularly concerned, is the cost differential resulting from practices or conditions permitted or provided by Federal law which are unfair or substandard by any criterion. Massachusetts manufacturing indus-

⁶⁶Grossman, “Fair Labor Standards Act,” p. 27.

⁶⁷Boles, “Some Aspects of the Fair Labor Standards Act,” p. 499.

⁶⁸S. Charles Maurice and Margaret Jane Hobson, *Minimum Wage Laws: Who Benefits, Who Loses?* (College Station, Tex.: Center for Education and Research in Free Enterprise, Texas A & M University, 1983), p. 18.

⁶⁹Henry Simons, *Economic Policy for a Free Society* (Chicago: University of Chicago Press, 1948), p. 135.

tries in May of 1953 paid an average hourly wage of \$1.64; but because the Federal minimum is only 75 cents an hour, many industries migrating to the rural communities of Mississippi pay workers only that less-than-subsistence wage, and those employees under "learners permits" even less. Practically all New England woolen textile mills pay a wage of at least \$1.20 an hour; but . . . the New England Mills must bid for government contracts against southern mills paying only \$1.05 an hour.⁷⁰

The 1955 debates over increases in the minimum wage were the sharpest North-South confrontation on this issue. With reference to Puerto Rico, President David Dubinsky of the International Ladies Garment Workers Union urged a congressional subcommittee to raise the minimum wage. The reason he gave was that the Puerto Rican brassiere industry was growing and that Northern knitting mills had begun to move to the island.⁷¹

In the 19 July 1955 House debate Representative Mack (Wash.) reveals why he supported an increase:

Mr. Chairman, in the three Pacific coast states of Washington, Oregon, and California about 600,000 men are employed in forest-product industries. . . . The lumber, plywood, shingle, veneer, doors, and furniture which these workers produce must be sold in competition with similar products made by workers in southern states. . . . The southern manufacturers thereby have a competitive advantage over our west coast mills, where wages are higher. . . . It is not fair that western producers of lumber, plywood, furniture, and other forest products who pay an average of \$1.80 an hour must compete with the southern lumber, plywood and furniture manufacturers who pay an average wage of only about 86 cents an hour. This unjust differential can be remedied by requiring that southern manufacturers pay at least a minimum wage of \$1 an hour.⁷²

In the same House debate, Representative Nelson (Maine) summarized his feelings about the minimum wage in these words: "Today the statutory minimum wage has a far broader purpose than that. . . . In brief, it is a salutary and excellent device to prevent competition between states and sections of this country."⁷³ He also conveyed the findings of a committee appointed by the Conference of New England Governors. They found that the major explanation of New Eng-

⁷⁰John F. Kennedy, "New England and the South: The Struggle for Industry," *The Atlantic*, January 1954, p. 33.

⁷¹Rottenberg, "Minimum Wage Laws in Puerto Rico," p. 338.

⁷²*Congressional Record*, 19 July 1955, p. 10978.

⁷³*Ibid.*, p. 10961.

land's decline in textiles was the large wage differential between New England and the South.⁷⁴

In 1960, Representative Lindsay (N.Y.) reminded his colleagues that he was supporting an increase in the minimum wage to protect the apparel industry in his district.⁷⁵ In 1966, Representative Resnick (N.Y.) favored increases in the minimum wage to protect farmers in the Northeast who paid workers \$1.25 to \$1.75 per hour from farmers in Mississippi who paid only \$3.00 per day.⁷⁶

Marshall Colberg, who views the minimum wage as a basic tool of the North to stifle Southern competition, recently tested North-South records on key votes. He looked first at the voting on the 1961 Monroney Amendment, which would have limited the coverage of the minimum wage for retail, gasoline station, laundry, and construction workers to firms established in more than one state. Colberg found that senators from Southern states voted 75 percent in favor of the amendment, while Northern senators voted 75 percent against it.⁷⁷

Surprisingly, however, Colberg also found that Southern senators voted by a large majority in favor of a 1966 bill extending minimum wage and overtime provisions to a larger number of workers in the District of Columbia. Indeed, "even such strong opponents of the federal minimum wage as Spessard Holland of Florida, Everett Dirksen of Illinois, and Sam Ervin of North Carolina voted yea. Evidently, voting on the minimum wage is not strictly a matter of principle."⁷⁸ In what has been called the "Colberg hypothesis," Colberg determined the anomaly was only apparent: legislators from more industrialized areas—including relatively more industrialized areas in the South—will always support the minimum wage as a device to reduce business migration from their districts to districts with lower wages. This hypothesis has found support in a test conducted by Jonathan Silberman and Gary Durden.⁷⁹

⁷⁴Ibid. Representative Gwinn (N.Y.) had some interesting comments to his colleagues that are still relevant today. He asked (ibid., p. 10955):

Where did Congress ever get its power except to seize that power, to say to a working man in America, "You shall not work for less than 75 or 90 cents an hour." That is the way this statute reads, in effect. It is not just that the employer must not pay less than 90; the employee must not work for less than 90.

⁷⁵*Congressional Record*, 30 June 1960, p. 15212.

⁷⁶Marshall Colberg, "Minimum Wages and the Distribution of Economic Activity," in *Economics of Legal Minimum Wages*, edited by S. Rottenberg, p. 249.

⁷⁷Ibid., p. 251.

⁷⁸Ibid., p. 253.

⁷⁹Jonathan Silberman and Gary C. Durden, "Determining Legislative Preferences on the Minimum Wage: An Economic Approach," *Journal of Political Economy* 84 (April 1976): 327.

V. The Prospects for Change

Before one can hope for the abolition of the minimum wage, the influence of the well-organized, special-interest groups that receive the bulk of the benefits from it must be reduced. There is, however, little chance that such groups as Northern unions and businesses, or interest groups in general, could be barred from the political process in the near future. Other options for change would include (1) payoffs to the vested interests, (2) two-tiered minimum wages, (3) inflation, and (4) general economic education of voters and victims.

Although paying off vested interests is theoretically possible, it would not seem very promising for two reasons. First, in order to compensate Northern unions and firms for their lost rents, taxes would have to be increased. This would merely shuffle the burden of the law, shifting it from teenagers to the general taxpayer. Second, it may be politically impossible to make direct transfer payments to these groups because the visibility of such payments could put the entire rent-seeking scheme in jeopardy. Since the societal costs of the minimum wage law could no longer be hidden, the payoff scheme would have to include a high risk premium to compensate for the probability of abolition by angry taxpayers.

Two-tiered minimum wage rates have been recently proposed by President Reagan, who asked Congress for a sub-minimum wage of \$2.50 per hour for teenagers for work done in the summer months.⁸⁰ In spite of evidence that such a minor reduction would result in the additional employment of 400,000–600,000 youths,⁸¹ the sub-minimum wage is legislatively dead. In 1977, Congress also turned a deaf ear to pleas from private youth-employment centers for a lower minimum wage for younger workers.⁸² The intellectual tide of opinion is moving toward favoring a two-tiered minimum wage, but it is not clear whether this movement will be translated into actual labor policy.

Inflation is sometimes considered an escape from the current minimum wage dilemma because it erodes a fixed minimum wage, eliminating its effectiveness. But this “method” poses serious problems. By using inflation to reduce minimum wage—created unemployment, greater unemployment could be created if in the process of monetary expansion relative prices are distorted in the structure of production,

⁸⁰Maurice and Hobson, *Minimum Wage Laws*, p. 18.

⁸¹*Ibid.*, p. 33.

⁸²*Congressional Record*, 6 October 1977, p. 32704.

thus causing malinvestment.⁸³ That is, inflation could initiate a trade cycle, bringing with it an ensuing depression.

Educating voters about the minimum wage may be the only lasting solution to the problem. The large number of victims must be made aware of the links between the minimum wage law and their plight. But this can be very difficult when politicians use the law to their political advantage and intentionally cloud the issue with emotional rhetoric. In trying to convince Americans of the necessity of the minimum wage provision in the FLSA, President Roosevelt used tactics like the following: "Do not let any calamity-howling executive with an income of \$1,000 a day . . . tell you . . . that a wage of \$11 a week is going to have a disastrous effect on all American industry."⁸⁴ Politicians have been extremely effective in making the minimum wage popular with well-intentioned voters.⁸⁵ Economists, on the other hand, have much work to do in the slow process of giving the average voter the economic education he needs to understand—and then abolish—the minimum wage.

VI. Conclusion

George Stigler may have startled some economists in 1946 when he claimed that minimum wage laws create unemployment and make people who had been receiving less than the minimum poorer.⁸⁶ Fifty years of experience with the law has proven Stigler correct, leaving very few defenders in the economics profession.⁸⁷

But economists have had little success in criticizing this very destructive law. Simon Rottenberg demonstrated the government's disregard for what most economists have to say about this issue in his investigation of the Minimum Wage Study Commission created by Congress in 1977. He noted the numerous studies presented to the commission that without exception found that the law had a negative impact on employment and intensified the poverty of low-income earners. The commission spent over \$17 million to conduct

⁸³See Friedrich Hayek, *Unemployment and Monetary Policy: Government as Generator of the Business Cycle* (Washington, D.C.: Cato Institute, 1979).

⁸⁴Grossman, "Fair Labor Standards Act," p. 22.

⁸⁵William Keech, "More on the Vote Winning and Vote Losing Qualities of Minimum Wage Laws," *Public Choice* 29 (Spring 1977): 134.

⁸⁶George Stigler, "The Economics of Minimum Wage Legislation," *American Economic Review* 36 (June 1946): 358–65.

⁸⁷Although there are a few supporters left such as John K. Galbraith, many "liberal" economists such as Paul Samuelson and James Tobin have recently come out against the minimum wage. See Emerson Schmidt, *Union Power and the Public Interest* (Los Angeles: Nash, 1973).

the investigation and on the basis of the evidence should have eliminated the law. What was the outcome? The commission voted to *increase the minimum wage by indexing and expanding coverage*. As dissenting commissioner S. Warne Robinson commented about the investigation:

The evidence is now in, and the findings of dozens of major economic studies show that the damage done by the minimum wage has been far more severe than even the critics of forty years ago predicted. Indeed, the evidence against the minimum wage is so overwhelming that the only way the Commission's majority was able to recommend it be retained was to ask us not to base any decisions on the facts.⁸⁸

It cannot be that our elected representatives in Congress are just misinformed with respect to the minimum wage law. To the contrary, the *Congressional Record* demonstrates that they fully understand the law's effects and how the utilization of those effects can ensure reelection. Economists would do well to realize that governments have little interest in the truth when its implementation would contradict self-serving government policies. Rather than attempting to bring government the "facts," economists should educate the public. This is the only solution to the malaise created when people uncritically accept such governmental edicts as the minimum wage.

⁸⁸Simon Rottenberg, "National Commissions: Preaching in the Garb of Analysis," *Policy Review* no. 23 (Winter 1983): 139.

IN DEFENSE OF THE INVISIBLE HAND

Norman P. Barry

Introduction

Despite the current intellectual popularity of free market philosophies and the increasing doubt cast on the idea that the political power of the state can improve upon the spontaneous workings of a decentralized, private property exchange system in the production of desirable social outcomes, criticism of the Invisible Hand hypothesis continues to flourish. Moreover, such criticism does not emanate solely from the members of some socialist ancien régime anxious to preserve an intellectually spent economic dynasty but from some of the most original and sophisticated economic and social theorists currently writing. Two outstanding contributions to this critique of classical economic liberalism are those of Frank Hahn and Amartya K. Sen, whose Fred Hirsch Memorial Lectures have attracted much attention.¹ What is of interest to the Invisible Hand theory in these articles, especially that of Hahn, is not that its critics wish to amputate the limb and replace it with some allegedly superior steering device, but that they seek only to expose infirmities in its joints and muscles and indicate some unsureness of its grasp. Nevertheless, the hand of friendship proffered by these writers seems limp enough to provoke some defensive reflections on behalf of spontaneous market forces.

The criticisms of Invisible Hand processes cover a wide range of economic and social issues. At the level of pure theory, there is the question of whether rational economic agents, driven only by self-interest, will produce an economic “equilibrium” and, further, whether

Cato Journal, Vol. 5, No. 1 (Spring/Summer 1985). Copyright © Cato Institute. All rights reserved.

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¹See Frank H. Hahn, “Reflections on the Invisible Hand,” *Lloyds Bank Review*, April 1982, pp. 1–21; and Amartya K. Sen, “The Profit Motive,” *Lloyds Bank Review*, January 1983, pp. 1–20. See also Frank Hahn, “General Equilibrium Theory,” in *The Crisis in Economic Theory*, ed. D. Bell and I. Kristol (New York: Basic Books, 1981), pp. 123–38.