The Impact of Minimum Wage on Small Businesses, Workers, and Employment in the United States

Dr. Navid Ghani
Five Towns College
Professor of Sociology and History
305 N Service Rd, Dix Hills, NY 11746
United States

Abstract

Minimum wage issues are one of the most controversial and political topics in American politics today. It often causes companies, corporations, and other commercial and public interests alarm in the lack of certainty and answers to, "What if…" questions. This paper examines some of the most important issues related to the effects of raising minimum wage, based on new contributions in theoretical and empirical research, roughly since 1990. My purpose is to find literature on an explanation for the recent raise of minimum wage in the United States and to identify possible effects of this development. So far, there is no evidence of significant job losses for the workers affected by the minimum wage in most business. I also found no measurable price increase of products in retail business. Most of the studies point little to no employment responses to modest increases in the minimum wage, but it remains to be seen what happens to poverty and inequality and how the future affects businesses if the minimum wage increases.

Keywords: minimum wage, poverty, employment, unemployment, labor market, turnover, low-paid workers, Keynesian Theory

1. Introduction

The minimum wage is getting maximum coverage these days. Increasing the minimum wage, as many argue, will not cause people to lose their jobs. A minimum wage spurs economic growth by giving workers more money to spend. This increases demand, which further boosts business growth. On Jan. 1, minimum wage hikes went into effect in 13 US states and several major cities, making 2016 something of a national experiment to test the effects of higher wages for the lowest-paid workers. The economic effects of raising the minimum wage are controversial. The positive part is that there will be a surge in the quality of lifestyle of millions of workers who are on the borderline of diverging to poverty or already living below poverty line. The Center on Budget and Policy Priorities (2015) states that minimum wages have never been adjusted automatically for inflation, its real (inflation-adjusted) value tends to fall in the years between enacted increases — as happened during the 1980s, from the mid-1990s until 2007, and after 2009. Such declines in the purchasing power of the minimum wage lower minimum-wage workers' living standards. The weight of this evidence points to the fact that millions of Americans in 2015 live below the poverty line. Raising the minimum wage will not only bring them out of poverty, it will also reduce the government expense for social programs. The U.S. Census Bureau reports (2015) that despite five years of economic recovery, poverty is still stubbornly high in America. More than 45 million people, or 14.5 percent of all Americans, lived below the poverty line in 2015 (U.S. Census, 2015).

The federal government defines the poverty line a family of four earning $24,300 as of 2016. It's based on a family's annual cash income, rather than its total wealth and annual consumption (Department of Health and Human Services, 2016). The Federal poverty level is updated in January of each year to keep up with inflation. The Federal poverty level is used by the U.S. government to define who is poor. Increase in minimum wage can help reduce wage inequality and bring millions of workers out of poverty. In addition, some other positive factors include an increase in motivation of workers and elimination of unequal wages, which in turn, will increase productivity. Akerlof and Yellen (1990), while introducing the efficiency wage theory state that higher wages can increase the incentive for people to work harder and thus higher wages may increase labor productivity. If firms have to pay higher wages, they may put more focus on increasing labor productivity, which increases efficiency of the economy. The idea of the efficiency wage theory is that it may benefit firms to pay workers a wage higher than their marginal revenue product. The argument is that paying workers a higher wage may lead to increased productivity from the worker. If a worker gets a relatively higher wage, he may feel more loyal and devoted to the company.

The unwelcoming part of wage increase can be the increase in unemployment, increase in market prices, which can eventually lead to inflation. This is a vital issue, which not only concerns minimum wage workers, but also the business owners. Economists say that higher minimum wages are an effective tool against poverty and inequality, but taken too far, they can diminish employment opportunities and will hurt American small business. Many economists explicably mention both strands of the literature. Nevertheless, it would be helpful if there were some way to determine which side has the more persuasive case. On both sides of the Atlantic, politicians are warming to the idea that mandating higher wages can help the lowest-paid. Here, the experience of Germany with the introduction in January 2015 of a national minimum wage of $11.50 an hour is highly instructive. As expected, the plan to introduce a minimum wage was met with alarmist warnings from mainstream economist and policy makers. For example, in their joint spring 2014 prediction, the German economic institutes warned of 200.000 jobs being destroyed and of a visible and immediate increase in unemployment from January 2015 onwards. However, what happened is the exact opposite.

Unemployment in Germany has not increased but continues to go down instead. It fell from over 3 million in January to 2.7 million in July 2015. In Britain, which has had a minimum wage since 1999, the opposition Labor Party is keen to persuade for higher living wages (Economist, 2013).

2. Different approaches to Studying Minimum Wage Issue

The idea of an increase in wages has a strong populist appeal among Americans where discussions about social class are nearly always framed in terms of the rich versus poor. One of the key foundations of the contemporary economy, the wage factor, could dramatically reduce the misery of the poor. What would it say if we didn't take advantage of it? Some economists and politicians maintain that higher minimum wage laws are an effective tool against poverty and inequality, while other says that it can diminish employment opportunities for many low wage employees as these laws by increasing unemployment increase the average poverty level. Thus, minimum wage laws may not even address their primary goal, which is to reduce poverty (Newmark &Wascher, 2010).

Minimum wage is defined as a wage fixed by the government or by contract either as the lowest amount that may be paid to employed persons generally or to a particular category of employed persons. Minimum-wage workers are all around, from supermarket cashiers to restaurant dishwashers to the guys pumping gas at gas stations and customer service representatives. Small businesses account for over 70 percent of all operating businesses in the United States. The economy is therefore largely driven by small business. Studies argue that when the government mandates that small businesses must pay employees more, all wages must relatively rise, as skilled and experienced workers become more valuable. Consequently, small businesses must downsize their workforces, initiate hiring freezes, or reduce employee hours and benefits (Meer, J. &Jeremy West, 2015).

The increase in minimum wage can also have drastic effects on the economy. If minimum wages increased to $15 or more as are suggested by many, Americans will see a substantial increase in unemployment rates and product prices. This can eventually lead to inflation. Considering the law of supply and demand, when prices go up, buyers will buy less. If labor becomes more expensive, employers will hire fewer workers. As for the law of supply, higher price of supplies will result in a surplus in supply. The higher the wage, the higher the number of workers willing to work, however, the number of workers hired will be lower. This increase in unemployment can hamper the price of goods and services. Since businesses have to allocate more money for wages, they will charge more for their products and services. This will be detrimental to the economy and business growth. In the most recent presidential debate (January 2016), former candidate Ben Carson stated, "A hike in wages is not an efficient way to reduce poverty. Every time we raise the minimum wage, the number of jobless people increases. Having a high unemployment rate will lead to the decrease in the economic potential of the country. This will, in turn, put the country into economic downturn."

3. Theoretical Framework

There are various theories regarding the minimum wage. Some believe it would circulate money into the economy faster, which would negate any negative effects on employment, or even improve unemployment rates. Others point to the economic theory of supply and demand, and claim it will increase the unemployment rate. Some believe that the minimum wage is a government mandate that interferes with the free market. Neoclassical economic theories present a clear projection: as the price of labor increases, employers will demand less labor. However, many recent studies testing this prediction have found very small to no effects of the minimum wage on the level of employment (Zavodny, 2000 & Cortes, 2004). These studies also agree that to conserve and protect our primary resources of human labor, the government must have some control over minimum wages and the exploitation of unorganized labor force.

Here, I found it useful to discuss Keynesian Theory of economics that have shown real life implications and provided the main inspiration for economic policy makers in Western industrialized countries since the Second World War. This theory suggests that wages should increase at least according to trend productivity growth plus the target inflation rate of the central bank because this is the only possibility to prevent an increase in the wage gap. It further suggests that the minimum wage must affect a sufficient number of employees and should be adjusted frequently. His economic theory was based on a circular flow of money, which refers to the idea that when spending increases in an economy, earning also increase, which can lead to even more spending and earnings. The theory argues that minimum wage increase is an important instrument in the fight against poverty. This theory further suggest that although an increase in minimum wages leads to a change in income distribution within wage earners and demand for the gross domestic product of a country most likely to increase, the employment effects are theoretically open. In this perspective, increase in minimum wages does not have a systematic employment effects such as technology, input, supply and demand. They are neither positive, nor negative, and are theoretically open.

The rationale of Keynesian theory has therefore played an important part in my decision to investigate minimum wage and its impact on small business and employment in the United States. If we believe in the argument that wage increase affects the economy then why in the era of Keynesianism (1946-1970s) when minimum wages were generous and often above the poverty line in many industrialized countries, did we had a high employment? I can test this by comparing the effect of minimum wage by looking at different studies mentioned below.

4. Past and Present Research on the Minimum Wage

In the early twentieth century, attempts to legislate a minimum wage at the federal level met resistance in the courts based on a free market and a liberty of contract principle. The federal government was not prepared to interfere with the prerogatives of employers. Once the Depression arrived, more than 25 percent unemployment rate was considered compelling grounds for state intervention and the establishment of a federal minimum wage (Levin-Waldman, 1998).

Since 1938, the federal minimum wage has been increased 22 times. Naturally, this was opposed by all the arguments with which we are familiar today: it would restrict employment, it would hurt business and drive away capital, and demand will fall as prices rise. However, what has been the result? For more than 75 years, minimum wages has gone up and the real GDP per capita has steadily increased. The hours of labor have been reduced, and the actual number of persons employed is far from falling. Thus, the legal minimum wage does not necessarily spell devastation, either for the employer or for business and companies. In 2014, in a letter to President Obama and congressional leaders, more than 600 economists, including 7 Nobel Prize winners in Economic Sciences wrote, "In recent years there have been important developments on the effect of increases in the minimum wage on employment, with the weight of evidence now showing that increases in the minimum wage have had little or no negative effect on the employment of minimum-wage workers, even during times of weakness in the labor market (Economic Policy Institute, 2014)."

As the national presidential primaries raged in early 2016, particularly with the Democratic candidates, the minimum wage debate came front and center. The Democrats candidate, Vermont Sen. Bernie Sanders has pressed fellow Democrat Hillary Clinton to endorse a $15 minimum wage. On February 10, 2016, Governor Andrew M. Cuomo announced a report by the State Department of Labor detailing the impact of a $15 minimum wage for New York workers. In total, 2.3 million New Yorkers will earn higher wages and as a result, increase spending power by more than $15.7 billion across New York State. "If you work full time, you shouldn't have to live in poverty – which is why it's time for New York to lead the way and pass a $15 minimum wage" (Long Island News, 2016). He further says that raising the minimum wage will restore economic justice to millions of people, and will lift families out of poverty and create a stronger economy for all. This national attention has helped reinforce support for the movement at the state level. David Cohen, the president of the Five Towns College (Performing Arts and Business College) presented a far more progressive idea in an interview while tying the minimum wage to inflation. He stated, "We need to negotiate a reasonable minimum wage that should be indexed to inflation so that we never have to have this conversation again."

Minimum wage workers will clearly benefit from the wage increase. However, what about businesses? How would higher wages affect them? Berkeley economist Michael Reich (2001) study shows that mandated wage increases for low-income workers does significantly reduce turnover. Another study by Economists Jonathan Meer and Jeremy West (2015) looked at how an increase in the minimum wage affects future job creation. They found that the minimum wage reduces net job growth, primarily through its effect on job creation and that those effects are more pronounced for younger workers and in industries with a higher proportion of low-wage workers.

Contemporary economic research casts a shadow of doubt on the contention that moderate minimum wage increases cause job losses and reduce turnover. However, researchers believe that the opposite is the case. Card and Krueger's study (1995) used a natural experiment on the impact on fast-food employment of the 1992 increase in the New Jersey state minimum wage. In advance of the 1992 increase in the New Jersey state minimum wage, Card and Krueger conducted their own telephone survey of fast-food restaurants in New Jersey and neighboring Pennsylvania. To confirm their results they also used payroll records from these restaurants. They repeated the survey after the increase had gone into effect and then compared the change in employment in New Jersey's restaurants (the minimum wage treatment group) with what happened in Pennsylvania (the control group). They found no evidence that the rise in New Jersey's minimum wage reduced employment at fast-food restaurants in the state.

Other studies have found that modestly higher minimum wages can raise incomes for low-wage workers without reducing the number of jobs in an area. Their evidence rests largely on comparisons between neighboring areas with different minimum wages and has significantly advanced the research on minimum wage employment effects. These studies compared all neighboring counties that are economically similar except for having different wages on different sides of a state border with different minimum wage levels between 1990 and 2006 and found no adverse employment effects from higher minimum wages (Allegretto, Reich, &West, 2014; Jacobs & Bernhardt, 2014; Allegretto & Pitts, 2013).These studies suggest that a minimum-wage increase could have a small simulative effect on the economy as low-wage workers spend their additional earnings, raising demand and job growth, and providing some help on the jobs front. These studies have even suggested that higher wages can increase employment, because they increase an employers' ability to attract, retain, and motivate workforce. In addition, studies have suggested that in implementing the minimum wage, it will be essential to monitor the program as it develops. Support will be needed for small business with fewer than 50 employees to make the transition toward higher wages.

The Fiscal Policy Institute (2004) released a study of the impact of higher minimum wages on small businesses. Their analysis focuses on various outcomes for businesses with less than 50 employees and at small retail businesses, comparing these outcomes between states with minimum wages above the Federal level and those at the Federal level. If the theory that higher minimum wages hurt small businesses is correct, then we would expect there to be less growth in such enterprises in states with higher minimum wages. In fact, the research suggests that the opposite is the case. For example, between 1998 and 2003, the number of small business corporations grew twice as quickly in states with higher minimum wages (3.1% vs. 1.6%).Employment grew 1.5% more quickly in high minimum wage states. Annual and average payroll growth was also faster in higher minimum wage states (Dube, Lester & Reich, 2010).

5. Discussion

From the research findings cited earlier, one can roughly translate these minimum wage increases into the overall job count. This means that the typical minimum wage worker is not a high school student earning weekend pocket money. In fact, 89 percent of those who would benefit from a federal minimum wage increase are age 20 and older. Women make up 48 percent of the work force yet 55 percent of the would-be beneficiaries of the increase in the minimum wage (New York Times, 2014).

So, what does all this mean for the low paid workers? One thing is for certain, arguments that the business cannot afford increasing the minimum wage because it will hurt the industry will not suffice. In fact, the trend seems to support the notion that the issue of minimum wage increases getting broad popular support. Polls conducted since February 2013 when President Obama first called on Congress to increase the minimum wage have consistently shown that an overwhelming majority of Americans support an increase (Hart Research Associates, 2015).Across all of the studies that have investigated in this paper, minimum-wage increases are consistently associated with positive and economically meaningful increases in the wages of low paid workers. I will even go further and argue that indexing minimum wage to inflation is perhaps a necessary step forward so it does not continue to fall in real value every year – on working families, local businesses, and state economies. Keynesian theory of economics is relevant to the fact that by improving pay in the low-wage jobs on which many workers are relying more than ever, an increase in minimum wage will help restore the consumer spending that powers our economy and that local businesses need in order to grow. When people have more disposable income, sales increase in volume. In fact, the business may actually end up with more profit and they may have to hire more people to meet the demand.

A 2014 study by the Congressional Budget Office (CBO) finds that a national minimum wage of $10.10 an hour would benefit some 16.5 million people, while leading to the elimination of 500,000 jobs due to cost cutting offsets. The ultimate effect is still a $5 billion increase in total income for people below the poverty line, pulling some 900,000 of them over the threshold. This study finds that the wage increase would help the economy today**.** Specifically the study finds that the extra purchasing power for workers will expand aggregate demand and strengthen the economy. As CBO wrote, "Raising the minimum wage increases that demand, in CBO's assessment, because the families that experience increases in income tend to raise their consumption more than the families that experience decreases in income tend to reduce their consumption. In the short term, that increase in demand raises the nation's output and income slightly."

Employees surviving at minimum wage are also often the same people who must rely on additional support of government run social programs such as food assistance, housing subsidies, education, and health support to support themselves and their families. Raising minimum wage means some of these people would be able to better support themselves without leaning as heavily on social programs and this would ultimately mean a reallocation of those funds to support other societal needs. Since the issue of minimum wage is a hot national political issue as many states have already increased the minimum wages in their states it will be interesting to watch whether it is a wiser course or not.

6. Conclusion

There is a lot of literature on the impact of minimum wages on business. Many studies show very little effect, but there is a substantial minority of studies that show the opposite. Though the general weight of evidence is on the side of minimum wage increases not being so bad, it isn't an overwhelming consensus. However, evidence presented above, along with much economic analysis of this issue, reveal that such moderate increases have no measurable negative impacts on jobs. In addition, the gains from the increase will largely rise to those in the bottom third of the income scale. The evidence is convincing that moderate increases in the minimum wage have provided meaningful additional earnings for many of America's most hard-pressed working families with no apparent negative employment effects. Increasing the minimum wage is one of the ways that government can help ensure that everyone continues to share in the benefits of growth. An increase would immediately put more money in the pocket of low-wage workers who will then spend the money on things like housing, food, and gas; especially in the locales, they live in — which, in turn, creates faster growth and more jobs. A positive advantage to businesses with a minimum wage is that workers would be less likely to leave to find a higher-paying job.

In short, politicians and policy makers should feel confident that raising the minimum wage would not hurt employment and business. Instead, it would require the kind of enhancement in consumer demand that our economy sorely needs. Thus, Keynesian theory reflects the fact that active government policy could be effective in managing the economy if, the people who receive this money than spend most on consumption goods and save the rest, and this extra spending allows businesses to hire more people and pay them, which in turn, allows a further increase in consumer spending and enhance the overall economy. Although, as mentioned earlier in the paper, the higher minimum wages are an effective tool against poverty and inequality, but taken too far, they can diminish employment opportunities. What happens next remain to be seen? When considering the minimum wage, this is the magnitude of the impact that policymakers should consider.

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