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Higher Minimum Wage May Have Unintended Consequences

By Anand Purohit, J.D. Candidate 2021 | March 14, 2019

A few weeks ago, Senator Bernie Sanders announced his candidacy for President of the United States. Joining a crowded field of Democratic hopefuls, Sanders called on his supporters to "complete the revolution" that he began in 2016. And, just as he did in 2016, Sanders is making wealth inequality a central issue of his campaign. When Sanders called for a $15 national minimum wage in 2016, the idea was derided as 'radical' and 'extremist.' Since then, both New York and California have passed legislation, raising their minimum wages to $15 per hour (the CA bill calls for an incremental increase, gradually raising the wage to the target level). Additionally, numerous cities across the U.S. have imposed a $15 minimum. Notably, Sanders' most recent attempt to pass a Senate bill raising the nationwide minimum wage to $15 was co-sponsored by Senator Cory Booker, Senator Kamala Harris, Senator Elizabeth Warren, Senator Kirsten Gillibrand, and Senator Amy Jean Klobuchar—all Democratic candidates for President. Indeed, the entire Democratic roster of candidates now seems to support the wage hike. While it was once a revolutionary idea, it has become the rallying cry of the Democratic Party.

Certainly, the idea has its merits. Raising the minimum wage can create incentives to work. Theoretically, 'voluntarily unemployed' workers may be encouraged by the prospect of earning $15 an hour as opposed to $7.25—essentially, the more a job pays, the more likely people are to do it. Further, some evidence suggests a correlation between wages and marginal productivity. That is, when you pay workers more, they actually become more productive. Perhaps most compelling is the moral argument. As Senator Sanders has said countless times, "if you work full-time, you should not live in poverty."

However, there are strong counterarguments counseling against the wage increase. A minimum wage is, in effect, a price floor. In a perfectly competitive market, setting a price floor above the natural equilibrium will invariably lead to excess supply. Stated in non-economic terms, a minimum wage will increase unemployment. If companies have to pay each worker more money, they will naturally hire fewer workers. At the same time, as mentioned above, the higher wages will incentivize more people to join the labor force. Due to the concurrent expansion of the labor force and reduction in hiring, we would see a massive glut in the supply of labor—simply put, a surplus of jobless workers.

In reality, the analysis is more nuanced. It is affected by the elasticity of labor-supply and a host of other factors. In fact, in some rare market scenarios (such as a monopsony), a minimum wage can actually increase employment rates. Still, as a general rule, a minimum wage translates to higher unemployment. Crucially, young people would be hit hardest by this increase in unemployment. Firms hire workers based on their marginal revenue product (MRP). With less experience and knowledge, younger workers tend to have a lower MRP. As such, they are the first to hit the chopping board when firms are looking to trim fat.

Hence, the debate rages on: Is a $15 minimum wage the path to greater and more widespread prosperity? A bigger pie and more equitable slices? Or, alternatively, is it a path to severe unemployment, particularly for young inexperienced workers? Amazon provides a perfect case study which may help us answer this question.

In 2017, Amazon acquired Whole Foods Market, Inc. Under mounting pressure from activists and politicians (including Sanders himself), Amazon raised the minimum wage of Whole Foods workers to $15 per hour. The move was applauded by Sanders, who commended Amazon for paying its workers a living wage. However, since the wage hike, Whole Foods employees have seen their hours drastically reduced. One worker experienced a 33% reduction in his hours—the cut was so drastic, he actually earns less money now, despite being paid a higher hourly rate. Part-time employees, who overwhelmingly consist of young people, saw the biggest cut with their hours dropping from 30 per week to roughly 20 per week. Meanwhile, full-time employees suffered a less dramatic cut, with hours falling from 37.5 per week to approximately 35 per week. One worker lamented, "Just about every person on our team has complained about their hours being cut…Some have had to look for other jobs as they can't make ends meet."

This comports with the above-described economic model. By setting a price floor above the natural equilibrium, Amazon created a surplus of labor—more employees were eager to work, but the company was correspondingly forced to pay fewer workers, since each worker now costs more. And, as per the economic theory, younger part-time workers were disproportionately impacted; their hours-reduction was almost 4 times greater than that of full-time workers. If the Amazon case study is representative, then a $15 national minimum may not be the best way to help low-skill workers. In an economy where many minimum-wage jobs are already disappearing due to automation, a wage hike would only further diminish the availability of these vanishing low-skill positions. Instead, subsidizing education, constructing affordable housing units, and expanding an earned income tax credit may be more viable options.