Economics

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Economics Thesis ment A single policy change such as ‘ minimum wage’ could result to economic problems.

Introduction

Lasting for two years, the Congress voted an increase in the federal minimum wage from $5. 15 to as much as $7. 25 – a 40% increase. According to Kane and Kim (2007), the Congress should take note that a minimum wage is a price control on labor that restricts economic freedom as a whole. (Kane and Kim, 2007) Increases its minimum wage could eventually result to a reduction in America’s labor freedom from 92% down to 87%. The journalists added that in a free market, companies needing more manpower simply increase the wage offering to keep up with the increase in demand for goods and services. Therefore, wages are considered a good indicator in employing people and expanding the business.

Evidences that Supports the Thesis Statement

Labor regulations like the ‘ minimum wage’ affects the price signals in the market by disturbing the supply and demand. The differences between the supply and demand for labor could harm many people with the use of a minimum wage. This is true in the sense that increasing the minimum wage could result to an increase in the prices of goods. High prices of goods will eventually decrease the demand for the specific goods. Thus, people would tend to

look for an alternative sources of similar item in order to maximize the value of their money. The SRAS curve would shift to the left; it means a decrease in the number of goods sold as prices of goods increases. (See Figure 1 – Aggregate Supply and Demand when Minimum Wage is Increased on page 4)

Increasing the minimum wage could affect the U. S. international competitiveness and labor freedom. People who support an increase in the minimum wage insist that it would help the poor and less-skilled workers. However, the government intervention on this matter has an adverse effect in the market place. The increase in the minimum wage could affect the supply and demand curve leading to a less efficient in the allocation of labor. Thus, resulting to an increase in unemployment rate. (See Figure II – Supply and Demand of Labor When an Increase in Minimum Wage is Implemented on page 4)

Each time the equilibrium real wage is not equal to the market-clearing real wage, the real wage becomes too high. In this case, some businesses would be forced not to hire additional manpower. For companies that are experiencing a bad business performance combined with a bad economic situation, some of these firms may choose to implement mass lay-offs or simply declare bankruptcy or closure. It simply proves that increasing the real wage too high would result to an involuntary unemployment.

Determining the wage efficiency is important in making decisions on whether to increase or decrease the minimum wage. Both ways could affect the performance of the company. Increasing the wage could motivate the worker to perform well in his job. On the other hand, the worker tends to work below his capacity due to lack of financial motivation. On the part of the company, the firm wants to maximize the most of each dollar spent on wages. Either way, increasing or decreasing the minimum wage should always be above the market-clearing wage.

Conclusion

In deciding whether to increase or maintain the minimum wage, a lot of

factors should be taken into consideration. Such that increasing the minimum wage too much would have an adverse effect to the country's economy in terms of a sudden increase in the unemployment rate (involuntary unemployment) and a disturbance in the supply and demand of goods and services.

Not allowing an increase in the nominal wage could have a negative effect too in the sense that workers will not be motivated to work at their best efforts. The lack of motivation in manpower would also have an indirect effect on the whole economy of the country.

For this reason, the increase in the minimum wage should be limited or a gradual increase in the minimum wage should be implemented over time. This will allow the market to have time to adjust to its equilibrium and avoid demand and supply shock within the U. S. economy.

*** End ***

Figure I – Aggregate Demand and Supply When Minimum Wage is Increased

Figure II – Supply and Demand of Labor When an Increase in Minimum Wage is Implemented

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A Higher Minimum Wage, Less Economic Freedom

Friday, March 16, 2007

By Tim Kane and Anthony B. Kim

Congress recently voted to increase the federal minimum wage from $5. 15 to $7. 25 over a two-year period — a dramatic 40 percent increase. Final

action on the minimum wage increase has not yet been cleared due to differences in the Senate bill and the House bill.

But Congress should be reminded that a minimum wage is nothing more than a price control on labor, which is a restriction on economic freedom. Any nation that raises its minimum wage compromises its economic freedom score in the annual " Index of Economic Freedom" from The Heritage Foundation and The Wall Street Journal. The proposed change could reduce Americas labor freedom score in the Index from 92 percent to 87 percent. America, now the fourth freest economy in the world, would drop to sixth place due to this single policy change.

In a free-market economy, prices allocate land, information, capital goods and labor to their highest use. Markets are truly free only if prices are free. For example, a firm that needs more workers signals its need to the labor market by offering a higher wage. Wages are good indicators that direct people to employment and show businesses how to expand. Freely floating prices allocate resources efficiently to places where they will take root and boost economic productivity.

Many types of labor regulations infringe on this market mechanism by disturbing price signals and, therefore, restraining the economic freedom of business owners and workers. One of the most prominent is the minimum wage. By setting a government-specified floor for workers wages, minimum wage laws tend to disrupt labor supply and demand.

The labor market is not excused from the basic economic principle that artificially high prices cause lower demand. In particular, less skilled workers will suffer. The mismatch between labor supply and labor demand is likely to harm the very people the minimum wage is intended to help. A recent

National Bureau of Economic Research study reviewed about 90 empirical papers from the early 1990s to the present. It found that two-thirds of those papers conclude that the effects of the minimum wage are negative. Further, among the most methodologically rigorous of those papers, " almost all point to negative employment effects." The study also revealed " relatively overwhelming evidence of stronger disemployment" impacts on less-experienced workers.

Of even greater concern, increasing minimum wage is likely to curtail one of the pillars of U. S. international competitiveness, labor freedom. Labor freedom, like property rights and business freedom, is fundamental to a countrys overall economic freedom as measured by the Index of Economic Freedom. The Index grades 157 countries economic freedom, and one of the Indexs 10 key components is a labor-freedom factor that measures the ability of workers and businesses to interact without restrictions imposed by the government.

According to the 2007 Index, U. S. labor markets are 92. 1 percent free. Raising the minimum wage, which is one of the four elements of the labor freedom factor, will lower the score for U. S. labor freedom. The amount of the drop depends on how the 50 states react, because many have higher local minimum wages and would presumably raise theirs in response to congressional action. The proposed increase in the federal minimum wage is estimated to reduce the overall U. S. labor freedom score by 1. 2 to 4. 8 percentage points, dropping the labor score potentially as low as 87. 3 percent.

Americas economy is currently rated as 82 percent free overall. The implications of the 40 percent increase in the minimum wage could drop that

score to 81. 5 percent free.

Supporters of increasing the minimum wage argue that they do so in order to help poor and less-skilled workers. But government intrusion into the labor market through raising minimum wage generates the same problems that similar interventions produce in other markets. The minimum wage disrupts the natural interaction of supply and demand and leads to inefficient allocations of labor and, eventually, increased unemployment.

Congress should reconsider increasing the minimum wage and look for ways to help American workers by increasing their competitiveness.

Tim Kane, Ph. D., is Director of the Center for International Trade and Economics at The Heritage Foundation, where Anthony B. Kim is a Policy Analyst.

References:

1 Kane and Kim (2007) ‘ A Higher Minimum Wage, Less Economic Freedom’ Retrieved: April 25, 2007 < http://www. foxnews. com/ >