Does an increase in minimum wage result in a higher unemployment rate research pa...

Business, Company

Q. Does an increase in minimum wage result in a higher unemployment rate?

Issues and Background

In response to the great depression of 1920s, minimum wage laws were introduced. As the economy was suffering from a big set back characterized by falling prices, falling output and falling employment, NIRA, National Industrial Recovery Act (1993) was introduced in an attempt to curtail this downturn, encouraging the trade associations to formulate agreements of minimum wages and establishes price floors. The participating firms used to display a " blue eagle" logo. But just after two years the Supreme Court Ruled NIRA as unconstitutional and all agreements made under this act were terminated. After three years in 1938, FLSA (Fair Labor Standards Act) established a minimum wage rate of 0. 25 Dollar per hour. Initially this act was applied to a small segment of labor force but was revised later and now it applies to about 90% of the workers.

Relationship between wage rate and unemployment has always been a controversial issue. The debate over the issue includes for and against claims regarding the impact on the employment levels. The backers are of the view that increasing the wage rate is a significant method of reducing poverty as getting paid more the purchasing power of the consumer increases. Whereas the opponents are of the view that wage rate hikes result in reduced employment opportunity as the businesses become less capable of paying off the salary, they thus cut down the size of the human resource employed.

According to Donald R. Deere,

“ The minimum wage does not prevent everyone from getting any job. But the minimum wage does make it more difficult for those who already have a hard time getting a job - the least skilled - to begin or continue a career.”

Some analysts support the increase in minimum wage rate by connecting it to boosted demand. As the workers’ purchasing power increases the demand for goods in the market rises, it may reduce the turnover but also takes the business towards high human capital model. The government has raised the min wage levels a number of times but the history shows, this raise has not shown any significant results related to reduced poverty and unemployment.

Analysis of the Relationship between Wage Rate and Unemployment: Facts & Figures

Studies released by The Employment Policies Institute (EPI), state:

“ For the 10-year period from 1997 to 2007, the minimum wage was $5. 15 per hour. Congress raised it to $5. 85 in 2007, then again to $6. 55 in 2008 and finally to $7. 25 in 2009 That means over that three-year span, businesses who rely on minimum-wage workers saw their labor costs jump 41%, right as the economic crackup began.”

The minimum wage job seekers are mostly the young and inexperienced workers. This segment has been hard hit by unemployment. Fox business report, reported that the youth unemployment rate was below 15 percent before the 2007 min wage hike, which escalated to 27percent by Oct 2009, and is still a very high level of 24. 6percent today. These studies suggest that increasing the minimum wage rate is not a good idea when addressing the poverty issues, rather there is a need of lowering the barriers to hiring not to raise them.

Given below is a figure from a report of Fox Business network which clearly shows the fall in the unemployment rate with the raise in the minimum wage rate.

Source: http://www. foxbusiness. com/economy/2013/02/13/higher-minimum-wage-higher-unemployment/

On the contrary, researchers have also found that increasing the minimum wage rate does not impact the unemployment levels even in the toughest economic times. Rather, the reduction in turnover and boost in demand are the facts that counteract the increased wage cost. Studies have shown that during 1960s the minimum wage rate was increased sharply, the unemployment rates were relatively much lower than in 1980s when there was a dramatic fall in the real value of minimum wage. If we observe across states, wage rate vary so does the unemployment rate, for instance in Nevada, min wage rate is $7. 25 per hour and the unemployment level is 10. 2%. On the other hand in Vermont, the min wage rate is $8. 60 per hour but the unemployment level is 5. 1%.

These figures reveal that other factors like overall economic and market conditions and the performance of the industries matter more for unemployment than the minimum wage levels.

Analysis of the Relationship between Wage Rate and Unemployment: Economist View

The basic economics relates minimum wage rate to the application of supply and demand analysis with initial assumptions of perfectly competitive labor market, minimum wage rate covering all workers and unaffected worker productivity by the wage rate.

With these assumptions, raise in minimum wage leads to unemployment in the markets where the equilibrium wage rate is lower than the minimum wage. An illustration is given below:

Here the equilibrium wage is W* whereas the equilibrium employment level is L*. With the raise of the minimum wage level W min, the employment level falls to L0. Hence the quantity of labor demanded at this minimum wage is higher than the quantity of labor supplied. Therefore LS - LD workers would be unemployed due to this rise in the minimum wage rate.

The impact of the increase in the wage rate on the marginal cost of the firm due to change in the unemployment rates is demonstrated below.

The figure shows the supply curve of a firm which is same as the marginal cost curve of the firm. With the rise in the minimum wage rate the wage cost of the firm raises from p to p', decreasing the output to y' from y, which is likely to decline more to y* due to the ripple affect. The MC thus shifts to the left from MC to MC'.

Conclusion

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