Negative impacts of minimum wage and anti sweatshop legislation

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Abstract

Purpose – The paper aims to combat economic illiteracy concerning poverty, minimum wages, sweatshops and working conditions.

Design/methodology/approach – The objectives were achieved by (among others) making a proper economic analysis of the unemployment effects of minimum wage laws. The main method(s) used for the research are empirical and theoretical.

Findings – The results point to *laissez-faire* capitalism as the last best hope for the poor, whether in third world countries or in advanced economies. If the minimum wage were ended, and sweat shop conditions allowed to be bargained competitively, the poor would be much better off. Happily, in the nineteenth century, these regulations were not in force, and as a result the advanced economies were allowed to advance.

Research limitations/implications – The implication of the present research is deregulation in the labor market.

Practical implications – The practical implications of such a legal change would be lowered unemployment rates, and an improvement in economic welfare on the part of the poor.

Originality/value – The present paper combines an analysis of minimum wages laws and sweatshop working conditions.

Keywords Unemployment, Pay differentials, Legislation, Trade unions, Poverty

Paper type Viewpoint

1. Introduction

The anti poverty movement has been hijacked by organized labor. Under the guise of helping the poor, unions have instead done their best to keep the “least, last and lost among us” mired in the poverty that now afflicts them. In section 2 we demonstrate this charge with an analysis of the minimum wage law. Section 3 is devoted to a discussion of anti sweatshop legislation, to this same end. We conclude in section 4.

2. Minimum wages

How can we help the working poor? How can we save them from big business oppressors, their supposed enemy? Some claim[1] that a legally mandated increase in wages would increase the buying power of the less well off and lead to a rise in their standard of living (Card and Krueger, 1994; Landsburg, 2004)[2]. But these assumptions are wrong. A forced increase in wages has a negative effect not only on the unskilled worker but also on the economy as a whole.

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Despite the views of the interventionists to the contrary, prices are not arbitrary. The market price tends to equate the quantity supplied and demanded, and this holds true for labor as well as all other goods and services.

No employer in his right mind would pay employees a wage higher than their productivity level. If he did so, he would suffer losses on each such transaction; the inevitable end result of such behavior on a wide scale is bankruptcy. No company is responsible to the whole of society in such a manner that it is obligated to go broke paying workers more than their productivity warrants. To think this is to utterly dismiss Smith's (1776/1979) "invisible hand" according to which the public good may be attained not out of self-immolation, but rather as the result of profit seeking and, yes, selfish behavior. States Smith (1776/1979 Book I, Chapter II, pp. 26-7):

> It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest. We address ourselves, not to their humanity but to their self-love, and never talk to them of our necessities but of their advantages.

Precisely. Poor unemployed people will be far more likely to attain a job if they can rely upon the self-interest of the employer, not his benevolence which, in any case, will spell the ruin of his company if he is forced to lose money on each hiring decision.

An employer is only going to demand labor as long as its marginal productivity is greater than the wage divided by prices (that is, the real wage). If the price of labor is above equilibrium this will create unemployment for the very workers it is supposed to help. If people are productive enough they will keep their jobs under the increased minimum wage, but new applicants who fall below this level will find it all but impossible to obtain even a low paying job.

The minimum wage law focuses on wages, not employment. The law sets the terms of whatever employment happens to occur. It is difficult to understand, therefore, why anyone educated on this subject would see a legally mandated wage increase as helping the poor. Artificially pushing wages above equilibrium renders previously legal jobs illegal. This necessarily causes unemployment (Thornton, 1996, p. 1). A person willing to take a job for less than minimum wage is now *per se* committing a crime[3] and may be forced to do just that in other only indirectly related areas. This may be in the form of under the table cash dealings, tax evasion, or involvement in addictive drugs or prostitution. When barred from legal employment by pernicious minimum wage laws, these latter activities may become their only feasible means of survival.

Yet another difficulty is that employers may be encouraged to look abroad for labor. Examples include many big name American companies such as Nike, The Gap and certain clothing lines at K-mart (Kathy Lee's). In the view of some, this will cause an even higher rate of unemployment in the US economy. But this is erroneous, for the money American firms spend abroad in such outsourcing (Anderson, 2004; Hazlitt, [1946] 1979) will necessarily come back to our shores to purchase domestic goods and services requiring yet more employment[4].

Another option is to automate jobs replacing the ever-increasing cost of human capital. Automatic elevators are a good example of this phenomenon (Block, 1991 [1976], p. 232). At a low enough minimum wage, they were manually operated. Now, because of forced wage increases all one has to do is push a button on a panel to reach one's desired floor destination. The market, which includes employers and their stockholders, realized that the added cost of labor was so inefficient that it found a much less expensive substitute[5].

This seems to be the growing trend in many industries. Other good examples are the automated check out counters at supermarkets, self-serves at cafeterias and filling stations, and teller machines at banks.

Rothbard (1988) states the adverse effects of a wage increase as follows:

> In truth, there is one way to regard the minimum wage law: it is compulsory unemployment, period. The law says: it is illegal, and therefore criminal, for anyone to hire anyone else below the level of X dollars an hour. This means, plainly and simply, that a large number of free and voluntary wage contracts are now outlawed and hence that there will be a large amount of unemployment. Remember that the minimum wage law provides no jobs; it only outlaws them; and outlawed jobs are inevitable result.

Minimum wage laws cause great harm. They create unemployment because pay scales are artificially kept at levels higher than worker productivity. When wages are not determined by the market process low skilled workers are the most affected by the increase in unemployment. Proponents of this law argue that a higher income for some outweighs the cost in job losses for others. The problem with this is that the laws tend to harm the very people they were intended, by some, to help.

According to Tier (2001), “a minimum wage law is simply a form of price control: it prevents anyone from selling his labor below a certain price.” These laws, in essence, outlaw employment. Thus in effect, it is illegal for people to work at a wage lower than that set by the government. The law forces the low skilled out of the work force by pricing them out of the market. “The minimum wage effectively unemploys all those whose productivity lies below the level pegged. In other words, at a minimum wage level of $5.15, all those with productivities of less than that amount are unemployed, assuming profit maximization behavior on the part of the employers” (Block, 2000). In a free market society, wages equal marginal revenue productivity. When they are greater than productivity, businesses operate at a loss. When less, wages are bid up to equal productivity. This equalization can stem from two different sources. First, the employee’s side: why would a laborer work for $5.00 an hour when the firm next door is paying $5.50 an hour for the similarly qualified? Second, from the employer’s side: companies will go as far away as Mexico to attract those being paid less than their productivity.

People are usually paid what they are worth. If not, then another company can almost always be counted upon to see them as an under priced valuable commodity. Their wages will be increased due to companies of this sort competing for them.

There is an inexorable tendency on the market for wages to equal productivity. If the minimum wage is put into place, or raised, employees will have to jump over a new barrier, or a higher one, in order to attain employment.

Some argue that if there was no government mandated minimum that wages would decrease substantially (Card and Krueger, 1994; Landsburg, 2004). Why then do many fast food establishments pay $7 or $8 and hour when the law requires only $5.15 per hour? What is it that keeps wages that are now slightly above the minimum from falling? The answer is that these wages are set by productivity, through the market. Wages would not drop to or below the minimum set by law because productive people would not stay in a job that was paying them less than their worth. They would either actively seek other posts, or passively wait for firms to seek them out. Similarly, businesses would either actively search for underpaid workers, or passively wait for them to appear on their doorsteps.

Not only will wages be competitive, but working environments will be improved under a regime of economic freedom. "For some people, other considerations are as important as wages, or even more important, such as congenial working conditions, special benefits or security. A free labor market presents a smorgasbord of possibilities, where government, by keeping out of the way, enables each consenting adult to creatively and imaginatively achieve his or her own potential." says Tier (2001). When the government steps in and artificially sets a rate at which employers must pay their employees, they are interfering with the market and thus hindering competition.

Most people who believe that minimum wages are beneficial, would not lose their own employment as a result of this law. But everything has a cost, and in the arena of minimum wage, that cost falls disproportionately on the poor and the young.

The two groups most negatively affected by the minimum wage are the poor and the young. A teenager's first job is often one that entails very little or no skills. It is a stepping stone into the workforce. A first job is one where skills are learned and developed. "The overwhelming majority of people who would be employed below any minimum wage level are people . . . who quickly graduate from [their] low pay. The turnover of workers at that wage level (in a free labor market) is very high" Tier (2001). If teenagers are denied this opportunity at an entry position, how will they develop much needed skills and work ethic? How will they learn the "value of a dollar"?

Advocates of the minimum wage claim it raises the average income of the lowest-income families. All evidence is to the contrary, though. "Every country with minimum-wage laws also has high and persistent levels of unemployment. Only in countries with no minimum wage laws is there little or no unemployment" (Tier, 2001).

What, then, is the real reason for this pernicious legislation? Every artificially mandated wage increase leads to a rise in unemployment. So why has this practice continued since its conception in 1938 with the Fair Labor Standards Act? It is "an ill wind that blows no good": there must be some segment of society that benefits from this law. And there is: organized labor. When unions demand wage increases, the first reaction of their employer is to substitute cheaper labor substitutes for this one suddenly more expensive factor of production. The firm would like to cut down on the number of highly skilled workers, and hire many more of lesser skills. The new combination, it is thought, could do the same job, but at a lower cost. This is the last thing unions would welcome as a response to their demands. In the old "blue collar" days, they would simply characterize these replacements as "scabs" and beat them up. But in this more sophisticated age, they advocate a far more "white collar" solution: price them out of the market with a minimum wag law (Evans and Block, 2002; Block, 1991). This strategy is far more insidious. For, on the one hand, then can actually pose as the benefactors of the unskilled, young, and minority member workers. On the other, they can in this way make it impossible for the employer to hire them, without lifting a single finger in violence.

Unionized workers are part of the group that would only benefit from minimum wage laws or living wage ordinances. If their wages were affected it would only be to raise them, as the employer now has fewer alternatives to their services.

The end result of the minimum wage is that the people who are thought to be helped by the laws are hurt most by the elimination of the jobs they are qualified to perform. Low income/low skilled workers, such as elevator operators, can only benefit from increases in the minimum wage in the short run, until industry can be rearranged to substitute capital or more skilled labor for them. Says Thornton (1996) "Call it a revenue raiser. Call it a sop to unions. Call it an election-year tactic to get votes. But don't call it a help to the poor who are fired or never hired, or whose higher earnings are taxed away, never to be seen again." Minimum wage laws outlaw employment, and that is never a good thing.

Let us conclude. Many advocates of wage minima see them as a floor under which wages will not be allowed to drop. The higher it is, the better off are the down trodden employees. The lower, the poorer will be these people. This is an incorrect way of looking at the matter. A more accurate analogy is that minimum wages are a barrier over which workers must jump in order to obtain employment. The higher it is, the fewer the number of jobs will be available. The lower, and the easier it will be to land a position. The fear is that without this floor, fat capitalist pig employers will grind down wages to the lowest possible level. But we have seen that this is a falsity. Wage levels are determined not by employer whim; rather, they are based upon worker productivity. If the floor theory were correct, moreover, why settle for minimums of $5, $6 or even $10 per hour. Why not be more "generous", and argue for floors of, say, $100, $1000[6], or even $1 million per hour. A moment's reflection on this example will show these levels as the barriers, not the floors, they are. For if it were required that any employee earn $100 per hour, only high placed consultants, lawyers, doctors, etc., could still have jobs. At $1000, only professional athletes, singers, and movie stars could hope to be employed. And, at $1 million per hour, not even Bill Gates could work.

3. Sweatshops

In April 1996, one of America's favorite talk-show hosts was accused of using child labor to manufacture her clothing line that was sold at Wal-Mart. Kathie Lee Gifford became the human rights activists' punching bag. She was constantly teased and tormented for exploiting children to sell her merchandise at a lower cost. What most remember is Gifford's emotional rebuttal on *Live with Regis and Kathie Lee!* which aired with her stating the following:

> You can say I'm ugly, you can say I'm not talented, but when you say I don't care about children, that I will exploit them for some sort of monetary gain, for once, mister, you better answer your phone, because my attorney is calling you today. How dare you![7]

Gifford would soon become the hate figure of human rights activists when she appeared before a congressional hearing, pleading her case. She was now the golden spokesperson for the activists, seeking retribution for those that worked in sweatshops, especially children who were earning meager wages and working in less than mediocre conditions.

Gifford is not the first celebrity to be dragged into the spotlight over this issue. Several others, including actress Jaclyn Smith, athlete Michael Jordan, and supermodel Cheryl Tiegs, have been made sensitive to the sweatshop issue. Said Tiegs: "By being in the spotlight, by my appearing on the cover of *Sports Illustrated*, I accept a certain moral responsibility."[8]

Tiegs' statement, which is obviously in the right vein considering her position in society, begs the question – Is there a moral responsibility to reduce the options of the poverty stricken by taking sweat shop opportunities away from? For, surely, from the fact that they voluntarily take these jobs, we can infer that these are the best options open to them of which they are aware. Are not "the exploited" employed and earning money for their families? Are not American consumers entitled to purchase merchandise at a lower cost?

If we are to say that Americans must pay more for their clothing because one group believes that another should be paid more is to deny us, particularly the poor amongst us, the ability to buy merchandise for less. That removes a form of freedom – the freedom of choice – from Americans. Can this denial of choice be considered fair? Does not this violate a right that activists' cry for?

For decades now, so called human rights activists have been calling for better working conditions amongst other things, including corporate responsibility. These people claim that companies care naught for their employees, forcing them to work in atrocious conditions and for measly pay. Amnesty International cites a company, Cape Plc, which is being sued by the UK for exposing its workers to asbestos in South Africa[9]. This organization states that the impending threat of legal action as well as a poor reputation are the primary reasons for action taking place in these companies.

But let us ask who is doing more for the third world poor: companies who employ them for a package of wages and working conditions these poverty stricken people regard as their best option (otherwise, they would surely quit the "exploiting" firm and work elsewhere), or those do gooders who grumble over the extant monetary and non monetary compensation? Surely, it is the former. The latter do little to help. Actually, if their demands are met, many of the multi national companies now located in the third world will move elsewhere, to the detriment of their present employees, who will now have to seek other opportunities that they regard as inferior to those they already have.

Other organizations, such as Co-op America, call for a bit more than what Amnesty does. They insist there is more to it than improved working conditions. This group of grumblers lists the following: a living wage, education and the right to self-determination[10]. If provided, they say, things will improve greatly for workers and, effectively, sweatshops will be no more. Indeed, Co-op America has compiled a "to-do" list which should bring about the end of sweatshop labor. They state that the "following elements are key to ending sweatshops once and for all."[11] The elements are:

> Full Public Disclosure – Companies must disclose the treatment and pay of workers – how and where products were made.
> Accountability – Full public disclosure must be backed with independent monitoring of working conditions and pay.
> Responsible Action – Violations discovered through independent monitoring must be corrected in a way that protects workers and their jobs. This includes paying for education for child workers found in factories and paying parents a living wage[11].

Let us examine a country previously mentioned, South Africa, and see how this plan would like play out. In July 2002, South African workers demanded a pay raise. Their monthly checks equaled out to R1900 ($316 in American currency) and they were asking for a raise of R300, making their monthly paychecks R2200 ($367 American)[12]. It seemed to be a fair and eminently reasonable demand since the poverty line in South Africa is at R2400. Roger Ronnie, the general secretary of the South African Municipal Workers Union, states that because of these meager paychecks, workers are forced to choose between electricity, water, and food. Sacrifices must be made by the worker in order to exist from day to day in South Africa.

This is all well and good but do they stop to examine the fact that these workers who are complaining actually have jobs? In 1996, the unemployment rate in South Africa ranged from 20 to 46 per cent[13]. Nearly half of the South African population that is capable of working is not. If the living wage is increased like Co-op America demands, this would further exacerbate the already vast unemployment. What would happen to those are not employed? These groups rank economically illiterate posturing over the welfare of the workers. They do not seem interested in enhancing and bettering the lives of those who are unemployed and impoverished.

While the South African Municipal Workers Union believes that striving for a higher minimum wage will benefit them in the long run, they seem to overlook some important factors which could easily cause a reversal of fortune. Let us suppose that the government agrees to raise the wage to R2200. If Employee A can produce at the level of R1900 but cannot at R2200, he will then be fired to cut back costs at the company. What most people do not realize is that wages are a price. Wages are a price that companies must pay in order to have their product made. If the price increases for the product, just as a consumer would buy less of it or not at all, so too does this occur between a company and its labor force. Employment will necessarily be cut back.

Not only would these workers be able to keep their jobs, others would be able to work as well. If Citizen B has a productivity level of R1850, he is close to being able to work at the R1900 level. Unfortunately, he has automatically been denied a job because the company would be paying him R50 more than he is worth. Why should a company waste its money in this way? Without the law in place, the company would be able to hire Citizen B at this productivity level, secure another person to manufacture the product and thus lower unemployment. Without the minimum wage law, far more people would be employed and would thus increase the quality of life for all of those around them.

But how does one deal with the quality of the work environment? The "activists" put the cart before the horse on this matter. They insist that working conditions be improved. They do not realize that the firm has an economic incentive to satisfy the workers in terms of the proportion of total compensation paid in money wages and in working conditions. Suppose, for example, that the total wage package, including wages and expenses paid for the comfort of the workers, is $100. Suppose, to take an extreme case first, the workers all want $100 in salary, and $0 in working conditions. Employers who do not achieve this proportion will suffer in the competitive process of attracting a labor force. Consider the case of a company that pays $60 in salary, and $40 in working conditions. In the eyes of the workers who prefer a $100-$0 split, the $40 spent on them to make the factory more comfortable is money wasted. They look at the package, and see compensation of only $60. If another employer came along and offered, say, $65 in salary and $5 in working conditions, the workers would desert their present firm and embrace the new one. Take a more reasonable case. The workers want $90 in salary, $10 in working condition improvements, while the company still pays $60 in salary, and $40 in working conditions. Again, a second firm could come along with a package more closely aligned to the desires of the workers, and attract them away from their present employer, while paying lower wages. For example, such employees might value an offer of $80 in take home pay and $10 spent on comfort on the job, for a total of only $90, rather than their present $60 in salary, and $40 in working conditions.

In rich countries, for every $100 earned, the workers are more likely to prefer a $60-$40 split. Groups like Co-op America and Amnesty International emanate from such areas. They are attempting to impose their first world proportions on third worlders with very different tastes. For shame!

Consider another case. Nancy Penaloza, a seamstress in New York, has worked in awful conditions, sewing business suits. These suits that sell for over $120 bring Penaloza roughly $6 per unit. She works at least 56 h a week to be able to provide her family with $207[14]. But this is not all that she experiences.

> The shop [where Penaloza works] is hot in the summer and cold in the winter, and the boss is angry and screams. [She] cannot ask him questions because [she] is scared he will hit [her]. There is one bathroom for 100 people. If [she] were to ask for overtime pay, [she] would be fired[14].

No one could deny that these are not wretched conditions. One might even draw the conclusion that Penaloza is abused. (If she is actually hit, that would certainly be the case.) But, at least in her own view, she now occupies the best opportunity she sees open to her. Rather than whining and complaining, organization of the ilk of Co-op America and Amnesty International ought to find her another, better job, or employ her themselves. This, they have not done, resting content to blame her present employer, who is at least paying her a compensation package she voluntarily accepts.

4. Conclusion

Benevolence is not enough. "The road to hell is paved with good intentions." Accurate economic analysis must be applied if the poverty stricken are actually to be helped. And if this is done, it is clear that the minimum wage must be abolished, and those who attempt to wrest "sweat shop" jobs from those who now rely on them should be ignored.

Notes

1. For a particularly ill informed discussion along these lines, see Chapman, (2005).
2. For a critique, see Becker (1995), Block (2000; 2001), Block and Barnett (2002), Burkhauser *et al.* (1996), Deere *et al.* (1995), Gallaway and Adie (1995), McCormick and Block (2000), Neumark and Wascher (1992), Rothbard (1988), Sohr and Block (1997), Sowell (1995).
3. This is merely a de jure crime. *De facto*, he will not be punished. Rather, penalties will be visited upon his employer.
4. If these foreigners insist on keeping this money, burning it, sticking it in their mattresses, etc., then it is as if they are giving us their labor for free. As no one, even the most ardent anti free traders, argues that reparations are of harm to the recipient country, this is hardly problematic.
5. This is not to say that automatic elevators would not have replaced manual ones, eventually, even in the absence of wage minima. The point is, this transition occurred too early, before the new technology would have otherwise been competitive.
6. A complication: at these gargantuan minimum salaries, virtually no one could work. It is thus difficult to see how present high productivity levels could be maintained, given that they are often predicated upon a mass consumer base, which would no longer exist.
7. Kathie Lee Gifford, quoted in "Child Labor and Sweatshops,"
8. Cheryl Tiegs quoted in "Child Labor and Sweatshops," http://library.cqpress.com/cqresearcher/document.php?id = cqresrre19960816&type = hitlist&num = 0&
9. Irene Kahn, "Taking stock: Corporate social responsibility and human rights," http://web.amnesty.org/web/web.nsf/pages/ec_briefings_fora_Irene%20K
10. "What Workers Want", www.sweatshops.org/educate/workers.html

11. "The Key to Ending Sweatshops", www.sweatshops.org/educate/key.html
12. Roger Ronnie, "South Africa: Municipal workers strive for living wage", www.greenleft.org.au/back/2002/499/499p18c.htm
13. "Unemployment is South Africa is Probably Lower than Estimated, says ILO Study: Income inequality and poverty pose major challenges", www.ilo.org/public/english/bureau/inf/pr/96-31.htm
14. "Child Labor and Sweatshops", supra, fn. 7.

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