



## **CLOSING THE GAP: WHY MINIMUM WAGE LAWS DISPROPORTIONATELY HARM AFRICAN-AMERICANS**

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**ABSTRACT.** The minimum wage stipulates who shall be unemployed: anyone not deemed to have a productivity level above that mandated by law (assuming profit seeking behavior on the part of the firm). This law does not require that any employer hire any employee. It only prohibits appointing someone to a job at a wage below the minimum. The present paper makes the case that the minimum wage is harmful to all workers with productivity levels that lie below the level stipulated by this law, and that it is specifically harmful to, and indeed motivated to some extent by prejudice against, African-Americans.

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Why are black unemployment rates higher than those of whites?<sup>1</sup> Common explanations include racism, lack of representation in government, or the market as an oppressive institution. All of these explanations fail: minimum wage laws are the real culprit. States Sowell (2015) in this regard:

Low-income minorities are often hardest hit by the unemployment that follows in the wake of minimum wage laws. The last year when the black unemployment rate was lower than the white unemployment rate was 1930, the last year before there was a federal minimum wage law. ... 'Incidentally, the black-white gap in unemployment rates for 16-year-olds and 17-year-olds was virtually nonexistent back in 1948. But the black teenage unemployment rate has been more than double that for white teenagers for every year since 1971. This is just one of many policies that allow liberals to go around feeling good about themselves, while leaving havoc in their wake.'

Section 1 considers three possible causes of the unemployment disparity, and ultimately rejects all of them. Section 2 provides a brief general history of minimum wage laws. Section 3 covers theoretical considerations of labor economics. Section 4 criticizes the prevailing wisdom that minimum wage laws, even if ineffective, are the result of well-meaning social advocates. Instead the history of these laws is one of deliberate collusion on the part of unions, particularly in an effort to disparage minorities and immigrant workers. Section 5 offers possible solutions to the gap in marginal productivity. Section 6 concludes.

### **1. Three Possible Causes of the Unemployment Disparity**

The most common explanation given for the high black unemployment is discrimination. The hypothesis is that employers fail to hire blacks because they harbor feelings of ill-will towards minorities. This seemingly plausible hypothesis fails to square with empirical data. Given that both legal and social standing for African-Americans improved steadily throughout the second half of the 20<sup>th</sup> century, the discrimination hypothesis would predict that the ratio of black to white unemployment would steadily fall concomitantly with the diminution of racist attitudes. The repeal of Jim Crow Laws, the Separate but Equal Clause, and the enactment of the various Civil Rights Acts all suggest that employment conditions for blacks would improve during this period.

The death knell for this hypothesis is that the data does not conform to it. In 1975 the black unemployment rate was 14.8 percent, while the white unemployment rate was 7.8 percent. The black to white unemployment ratio was thus less than two (Reynolds, 1995, 43). Yet in each year from 1980 to 1993 this ratio was greater than two (Pew, 2013). If discrimination were the

significant factor contributing to black unemployment, then one would expect the data to show the very opposite tendency. The fact that black unemployment *increased* relative to white unemployment during this period shows that discrimination is at best a very weak factor in explaining black unemployment. More accurately, the one cannot possibly be the cause of the other.

Another possible explanation for high rates of black unemployment is the relative absence of members of this community in Congress. This branch of government writes the laws, after all, and therefore sets the rules of the game. Blacks are underrepresented in Congress, so perhaps their employment interests are denigrated. This hypothesis fails for the same reason as the one about discrimination – the data fails to support it. While it is true that blacks are still underrepresented in Congress, this disproportion *fell* during the same period that the black to white unemployment ratio rose. “Subsequently, the number of African American Members steadily increased. In the 98th Congress (1983–1985), the number surpassed 20 for the first time and in the 103rd Congress (1993–1995) reached 40” (Manning). The underrepresentation hypothesis would predict that black to white unemployment would *fall* as a consequence of black gains in Congress, but the data do not bear this out.

## **2. A Brief History of the Minimum Wage**

There are many different theories as to when and where the first wage laws appeared in the world. We will focus on England and the United States, since their labor laws are most consistent with today’s minimum wage. Wage laws were first introduced in 14<sup>th</sup> century England, right after the Black Death. “The plague killed off a substantial portion of the population, resulting in a shortage of workers” (How the Black Death). The laborers who survived demanded triple the wage that they had been receiving before the plague. In response, King Edward III issued the “Ordinance of Labor,” which was a ceiling on wages (How the Black Death). “Until the early 17<sup>th</sup> Century, no major changes were made to the Ordinance of Labor in England” (How the Black Death). “In 1604, the Ordinance of Labor was repealed and replaced with an ‘Act Fixing a Minimum Wage’” (How the Black Death). This was an act directed towards workers in the textile industry who were supposedly being “exploited” at the time, and King James found it necessary to introduce a floor under wages. The “Act Fixing a Minimum Wage” was upheld until the industrial boom of England in the 19<sup>th</sup> Century. Then the minimum wage law was repealed, and the free market determined wages. Although stable for the time being, “the argument over wages didn’t disappear” (How the Black Death).

The U.S. Supreme Court declared early attempts at a minimum wage law unconstitutional until the Great Depression arose in the 1930s. During the

great depression, wages were low, thanks to massive unemployment. In an attempt to gain re-election, Franklin D. Roosevelt made a strong push for a minimum wage. After his election in 1936, Roosevelt signed the Fair Labor Standards Acts (FLSA), which was implemented in 1938 (History of the United States). The FLSA became the first federal minimum wage law, with a \$0.25 price floor on wages and a 44-hour work week ceiling (History of the United States). After the FLSA was introduced, Congress made slight changes to the minimum wage every few years in order to account for inflation and the cost of living until 1997 (History of the United States).

In 1997, President Bill Clinton passed legislation that enabled each of the 50 states to individually set their respective minimum wages (History of the United States). In 2013, the federal minimum wage was \$7.25, and there are 19 states with levels higher than that (Minimum Wage Laws). Subsequently there has been mounting pressure on Congress to raise the federal minimum wage.

President Barack Obama has proposed increasing the federal minimum wage, from \$7.25 to \$9 an hour, as well as tying future increases to inflation, so that it will adjust automatically with the cost of living. The President said that the *goal* of the proposal is to *boost* the wage of 15 million minimum wage workers. He stated (Lowrey, 2013): “Even with the tax relief we’ve put in place, a family with two kids that earns the minimum wage still lives below the poverty line. That’s wrong ... Let’s declare that in the wealthiest nation on earth, no one who works full time should have to live in poverty.”<sup>2</sup>

However, that cannot be the real goal of the proposal, since in the long run it is impossible to raise wages merely by passing a law. Some people clearly benefit from an increase<sup>3</sup> in the minimum wage, but they are not the minimum wage worker themselves. Quite the contrary, as has been demonstrated above, there is nothing more harmful for the minimum wage workers than an increase of the minimum wage.

One argument, nevertheless, in the increase’s favor is the idea of “fairness.” For instance, Robert Reich, former Labor Secretary during the Clinton administration, argues that raising the minimum wage is not only *fair*, but would also help boost the economy. Furthermore, others argue that a mandatory increase of the minimum wage 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).

It’s true that the day after passing the minimum wage law wages will increase from \$7.25 to the new minimum level. But this is not a long lasting situation. As we have seen, companies will adjust and find a more competitive way to use their workforce because they cannot face long-lasting losses. The result of the minimum wage increasing \$9 an hour, then, will be negative for low-wage workers.

### *Internship Exceptions*

One exception to the minimum wage law is the intern. The majority of interns are youth who are willing to work for little to no money in order to gain knowledge in a certain field of work and, in turn, boost their productivity levels. In reality, unpaid interns are illegal under the minimum wage law. However the government has chosen to ignore this fact, which is a major contradiction to the law. The main reason the government has chosen to ignore the exception of internships is because nobody is being harmed; there are two mutually agreeable people who are gaining something from one another. The intern is gaining knowledge from the employer, while the employer is gaining an employee who is willing to do labor for little to nothing. Nobody is forcing either the employer or the intern into this situation; they are both doing it by choice and therefore should be able to take part in this mutually beneficial agreement.

For the government to step in and say that this agreement is a violation of the minimum wage law, and therefore is illegal, is synonymous with preventing the freedom of choice of the intern and employer. Interns are voluntarily agreeing to unpaid employment because the knowledge they gain is worth just as much, if not more, than the money they would be receiving. One could easily switch out an intern with someone whose productivity level is \$5 an hour. If that person is willing to work for \$5 an hour (\$2.25 lower than the minimum wage), and the employer is willing to pay that worker \$5 an hour (their productivity level), then they should be allowed to have that voluntary agreement. However, under the minimum wage law, the employer would be thrown into jail.

Congresswoman Nancy Pelosi recently revealed her double standard on the minimum wage in an interview with “The Bottom Line.” Pelosi is a major advocate for the minimum wage, however in the interview she stated that she has unpaid interns who are voluntarily working for her office (Pelosi). Under the minimum wage law, her hiring of unpaid interns is illegal.<sup>4</sup> The interviewer then asked her “if someone wanted to voluntarily work for McDonalds for \$5 an hour, shouldn’t they then be able to do that?” This member of Congress had no answer for him (Pelosi). She eventually stated that this would be against the law, but her unpaid interns are doing the exact same thing. Pelosi ended the interview after a few more questions threatened to call the police to escort the interviewer out of the room.

### **3. Theoretical Considerations**

Perhaps the failure to close the gap between black and white unemployment is caused by some flaw in the free enterprise system itself. In order to evaluate this claim, one needs recourse to a theory of how employment is

determined in the market. Labor services are bought and sold in the same manner as other goods. While it is true that each employer would like to pay as little as possible in order to hire the services of labor, each worker would also like to be paid as much as possible in exchange for his services. The market price will settle somewhere in the range of the marginal buyer's willingness to pay for labor and the marginal seller's willingness to sell it. If there are numerous suppliers and demanders, then at least at equilibrium, the wage should settle at the level of marginal revenue productivity of the employees.<sup>5</sup>

In this regard labor is no different than other commodities; it tends toward a market-clearing price, and this tendency is threatened by government intervention which abrogates the process. Just as setting the minimum price on the sale of a good or service above market clearing will create a surplus of the good or service – with some producers making goods that go unsold, and some consumers who were willing to buy at the old price now unwilling to do so at the new price – so does setting the price above market clearing create a surplus of labor in the labor market.

Much of the confusion on this topic stems from the failure to apply the economic tools of analysis to labor. It is customary to refer to goods as having a price, and labor as receiving a wage, but a wage is nothing but the price of labor. Just as consumers recoil at the thought of a minimum price that they must pay for goods and services, so employers respond to a minimum price for labor by demanding a lower quantity of labor. This surplus of labor – unemployment – is a consequence of interference with the market, rather than the market process itself.

This insight shows the error in blaming the free market for unemployment, and also points to the genuine cause: minimum wage laws. We have seen that minimum wages set above the market clearing price result in unemployment, but labor is not homogenous. A minimum wage law that results in a surplus of labor in one industry may not do so in another. A minimum wage law of \$15 per hour would very quickly disemploy low-skilled workers, but would not result in hospitals firing surgeons. Minimum wage laws, therefore, cluster unemployment at the levels near and below the wage that is now outlawed. Instead of hiring someone with a lower productivity, the business owner can instead only hire a certain amount of people with higher productivities (Dorn). In this way, the minimum wage is effectively pricing out the low-productivity workers for that is precisely what a minimum wage law does – it makes it illegal for an employer to pay an employee below a certain level.

The popular rhetoric in support of minimum wage laws is that they act as a floor which pulls up workers' remuneration. A more appropriate metaphor is that they are a hurdle over which a worker must jump in order to obtain a job. Responding to this idea, Block (2008a, 160) notes:

The minimum wage does nothing of the kind. It does not at all establish anything, let alone a 'wage floor.' Rather, it states that it shall be illegal for an employer to pay, and employee to receive ...any amount less than that stipulated by law. But there is no requirement, none at all, that a job, any job, be offered at this wage.

A 'wage floor,' moreover, implies that when the minimum wage level rises, it pulls wages up with it. If we must use mechanical analogies to economic phenomena, a far better one would be that of the barrier over which one has to jump in order to land a job; and, the higher is this hurdle, the fewer those who can catapult over it.

#### **4. Well-meaning?**

The unemployment attending minimum wage laws is no surprise to some of its advocates. Instead, these effects are often the main reason that certain groups advocate these policies at all! Sowell (2013) notes: "Minimum wage laws can even affect the level of racial discrimination. In an earlier era, when racial discrimination was both legally and socially accepted, minimum wage laws were often used openly to price minorities out of the job market."

Sowell goes on to cite the intentional discrimination against minorities as a cause for the enactment of minimum wage laws:

In 1925, a minimum wage law was passed in the Canadian province of British Columbia, with the intent and effect of pricing Japanese immigrants out of jobs in the lumbering industry.

A well regarded Harvard professor of that era referred approvingly to Australia's minimum wage law as a means to 'protect the white Australian's standard of living from the invidious competition of the colored races, particularly of the Chinese' who were willing to work for less.

In South Africa during the era of apartheid, white labor unions urged that a minimum wage law be applied to all races, to keep black workers from taking jobs away from white unionized workers by working for less than the union pay scale.

Some supporters of the first federal minimum wage law in the United States – the Davis-Bacon Act of 1931 – used exactly the same rationale, citing the fact that Southern construction companies, using non-union black workers, were able to come north and under-bid construction companies using unionized white labor.

It turns out that discrimination *was* a factor in the ratio of black to white unemployment, but not for the reasons commonly given. Despite the prevalence of discriminatory attitudes in 1930s America, this racism did not prevent whites from hiring blacks. Why would this be? The tendency in the labor

market is for an employee to be paid according to the discounted value of his contribution. If blacks were willing to perform the same work for less pay, empirical reality demonstrates that whites quickly overcame discriminatory attitudes thanks to the opportunity to increase profits.<sup>6</sup> In this sense the market acted to overcome racial preferences against a minority group.

Unions are one of the main forces behind the minimum wage law. As explained in Block's (2008b), skilled and unskilled workers are actually in competition with each other for employment. Therefore, unions were invented to price unskilled workers out of the market.<sup>7</sup> The best way to do so out of the market is to lobby for a law to be passed, such as the minimum wage, which sets the minimum wage higher than unskilled workers' productivity levels. Congress decided to pass the minimum wage law, to a great degree, because of the financial power that unions have over the market.

Under crony capitalism, those who wish to boost their own wage rates at the expense of minorities could lobby for laws that would legally bar the latter from competing with them. Racism did play a historical role in creating high unemployment for blacks, but it was not on the side of employers who refused to hire them; instead it was on behalf of groups that lobbied for minimum wage laws in the first place.

## **5. What Policy Implications Does This Analysis Hold?<sup>8</sup>**

What can be changed to undo the damage already caused? The simplest step is to eliminate minimum wage legislation entirely. The greater incidence of unemployment among blacks is a consequence of the lack of employee freedom imposed through these laws. Even on the assumption that the African American community attained, on average, lower marginal productivity, there would still be no reason in a free market setting for them to be disproportionately unemployed. It is simply not true that "it pays" an employer to hire higher-skilled workers instead of lower-skilled workers.<sup>9</sup> This is not the case because the employer is the one who has to pay for the increase in skill level. Minimum wage laws, then, take away from low-skilled workers the advantage they have against high-skilled workers – their willingness to accept lower pay.

Another implication is that the key to raising wage rates is not legislation; rather, it is to increase worker productivity. One way to increase worker productivity is to whittle away the draconian system of compulsory education. Caplan (2011) provides a trenchant critique:

It is only a slight exaggeration to compare academia to opera. Both are great for the small minority with the intellect and inclination to appreciate them. The rest of the population has little use for either – and there's no good reason to force it down their throats. In fact, there are good reasons *not* to do so. Imagine forcing everyone in

Yankee stadium to attend the Metropolitan Opera instead. For every Yankee fan who discovered the magic of opera, a hundred or more would be horribly bored and resentful. In their boredom and resentment, they'd complain and fidget, marring the experience for the genuine opera fans.

The same principle is at work in classrooms all over the world. Educators pressure or compel students to study high culture they're never going to use in real life, then wonder why it's so hard to teach them anything. Meanwhile, the students who actually want to learn are bored by the slow pace and endure their disgruntled peers' emotional abuse. What a waste.

Rather than compelling children to attend school, governments should recognize that it is foolish to force education on those who do not want it. The present system taxes people who may not have kids to provide unwilling children with an education. It would be far more valuable for all parties involved if more teens sought vocational training or apprenticeships. Those who opted out of school would have worked and earned, and learned from on the job training; the taxpayers would appreciate the reduction in the tax burden; everyone would benefit as a consumer from the increased numbers in the labor force.<sup>10</sup>

Another way to increase worker productivity, especially among blacks, is to end the drug war. Blacks are disproportionately represented in prison, and most people in prison are serving sentences for non-violent offences. There is a strong analogy between compulsory education and prison terms for non-violent offenders. Both groups currently represent a burden to the taxpayer. Both groups learn few, if any, valuable skills. This is especially true in the case of prisons. A man who goes to prison because of drug possession represents no threat to society. Indeed, he contributes positively, almost heroically (Block, 2008b, 30):

Since it is not the sale or use of heroin itself that is responsible for the plight of the addict or for the crimes he commits, but rather the *high price of heroin* caused by its prohibition, it must follow that any action which results in a drop in the price of the drug alleviates the problem. If the problem is caused by the high cost of the drug, then lowering the cost must be considered as a solution.

But it is the heroin pusher who is instrumental in lowering the price of the drug and the forces of "law and order" who are responsible for raising these prices by interfering with the activities of the pusher. Therefore, it is the much reviled drug dealer, not the widely beloved narcotics agent ('narc'), who must be considered the heroic figure.

But by throwing in his lot with dangerous inmates, the government teaches him to think and act like a hardened criminal. The effect of the prison

environment is unambiguously negative. A prison sentence for a non-violent offender does not simply deny society of the value of his contributions; it does not simply increase the tax burden; it actively increases the likelihood that the man will in fact commit a dangerous crime in the future.

A third method of increasing worker productivity and wages concomitantly is to decrease corporate taxes. This paper has demonstrated that legislative attempts to increase worker prosperity are ineffective. This is because workers are paid according to their discounted marginal productivity. To increase wages without increasing worker productivity requires the disemployment of workers below that level of productivity. Worker productivity is a consequence of numerous factors: worker discipline, motivation, training, and on the job experience. Yet each of these factors pales in comparison to capital invested per laborer.

The reason modern workers are more productive than those of previous generations is not their work ethic. It may be partially explained by increases in intelligence,<sup>11</sup> but the increase in intelligence has not kept pace with increases in worker productivity. No, a much better explanation is that workers today use far more capital than workers of the past. A single cell phone contains more computing power than the computers used by NASA to launch the first shuttle into space.

Even blue-collar jobs benefit from increases in capital invested per worker. A constructionist today may operate a crane that contains air conditioning and a cup holder. His working conditions are preferable to the historical method of digging with a shovel, yet this crane operator is simultaneously far more productive. Executives' decisions to invest in capital are not benevolent.<sup>12</sup> They do not aim to increase the wages of their employees. Yet this investment inevitably results in precisely that. A simple way to free up resources for capital investment would be to reduce corporate taxes. These corporate taxes limit firms' ability to further invest, and this limitation suppresses wages below the level they would attain without the tax burden.<sup>13</sup>

## **6. Conclusion**

Hypotheses that attempt to account for the height of black unemployment fail when they do not properly identify the true culprit: minimum wage laws. These laws do not, as their advocates claim, help the poor; instead the poor are inevitably most hurt by them. This knowledge is a feature, not a bug.<sup>14</sup> The history of minimum wage laws is a history of racist policies.

The key to increasing wages is to increase worker productivity. This can be achieved largely by pulling back existing legislation. Allow children to enter the labor field rather than compelling them to sit in classrooms against their will. Release non-violent offenders from prison, so that they can once

again contribute to society. Lower corporate taxes so that workers will benefit from the increase in capital invested. In short, remove still-existing laws, like the minimum wage, that have been among those oppressing minority groups in America.

## NOTES

1. The authors thank Bradley Warshauer for an excellent editing job.
2. It would be nice, no, it would be deliriously wonderful, if nice declarations like this would come true as a result merely of being made. Of course, “if wishes were horses, beggars would ride.” Why not also declare that “in the wealthiest nation on earth” the force of gravity is hereby repealed, or Canute-like, that the tides should obey the President’s edict?
3. We discuss this in section IV below. Hint: high paid unionized workers are the main beneficiaries.
4. That is, it *would* be illegal if the law were rigidly enforced in situations like this, which it is not.
5. Actually, more technically speaking, at the discounted marginal revenue product level. Block (1990).
6. The desire of racist employers to indulge in this taste of theirs was in effect outweighed, in their own minds, by their greater desire to earn profits. Suppose this had not been the case. Then those firms with the greatest commitment to discriminatory practices would have been the first to go bankrupt, as they would hire more expensive white labor instead of equally productive black workers.
7. Unions mainly consist of upper class Caucasians who are trying to price under skilled minorities out of the market.
8. Strictly speaking, no public policy implication of the sort “we should do X, or not do Y” follows from these considerations. This is because there is a gigantic Humean chasm between the “is” of the premises and the “ought” of the conclusion. So, we hereby offer a minor ethical premise with which few will quarrel: it is a desirable goal to reduce unemployment, and to rectify the plight of African-Americans. See on this Capaldi (1966), Hume (1739), Hunter (1962), MacIntyre (1959) and Searle (1964).
9. This depends, intimately, on the two wage levels.
10. Even better than to gradually reduce the public education system would be to eliminate it altogether in favor of a private system. There is nothing sacrosanct about education; just as the private sector does a better job of providing pencils and chewing gum, so too would it do (and already does) a better job of providing education.
11. This is largely attributable to improved nutrition; the same reason people are steadily growing taller
12. Says Smith (1776, 26–27): “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.”
13. Again, the ideal tax rate would be zero.
14. In the language of computer programmers.

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