

## **Minimum Wage in the United States**

Madeleine Reid

Department of Business, Webster University

ECON 2000 10 SP 2020: Survey of Economics

Sarah E. Dubberke

April 26, 2020

### Executive summary

According to the International Labour Organization, a “minimum wage” can be [defined](#) as “the minimum amount of remuneration that an employer is required to pay wage earners for the work performed during a given period” (para. 1). While it is not an international standard, it is a law in the United States. The United States’ minimum wage laws follow the above definition at both the federal and state level. While minimum wage applies to the majority, there are a handful of exceptions listed within the Fair Labor Standards Act. In addition, the concept of a minimum wage has been a controversial topic among economists, politicians, and civilians. Using the laws of supply and demand, economists criticize the effects of increasing the minimum wage. Some have done case studies around the United States leading to conclusions that both support and disprove some of the criticisms or assumptions made of an increased minimum wage.

*Keywords:* Minimum Wage, Fair Labor Standards Act, Federal Minimum Wage, State Minimum Wage, Inflation, Exceptions, Laws of Supply and Demand, Market Equilibrium, Price Floor, Surplus, Unemployment, Cost Efficiency, Federal Budget, Case Studies

## **Minimum Wage in the United States**

### **The Issue defined, Important History, and Background of Minimum Wage**

In the United States, the federal minimum wage was established by President Franklin D. Roosevelt and Congress under the 1938 Fair Labor Standards Act (FLSA). The FLSA was formed as a response to the Great Depression and the need for more jobs and labor regulation (Cole, 2016). The federal minimum wage within the FLSA set the lowest hourly rate an employer could legally pay employees (Center on Budget and Policy Priorities [CBPP], 2018). Currently, the federal minimum wage is enforced by the Wage and Hour Division of the United States Department of Labor (Wage and Hour Division [WHD], n.d.a.).

Increasing the federal minimum wage is not easy as the two different branches of government play a role in creating and controlling the minimum wage. In order for the federal minimum wage to increase, Congress must write and pass a bill that the President will sign into law (WHD, n.d.a.). Most federal minimum wage increases are due to inflation and adjustments for the cost of living. Because of this, the federal minimum wage has only increased 22 times since 1938, when it was established at 25 cents an hour, an equivalent to \$4.45 an hour when adjusted for inflation (Kurtz, 2019). Because a mandatory minimum wage sets a price floor for labor at the local, state, and national level, it can affect the labor market, which is why increasing it is a controversial topic.

A minimum wage is not only established by the federal government; state and local governments can also establish it. State and local governments can create their own minimum wage that may be higher, lower, or equal to the federal minimum wage. In the case where a state has no minimum wage law or its minimum wage is lower than the federal minimum wage law, employees are entitled to the federal minimum wage. If the state or local minimum wage is higher than the federal minimum wage, employees are entitled to the wage set by the applicable

state or local government (Krulick, n.d.). Thus, the employee is entitled to the higher of the minimum wages if subject to federal and state/local minimum wage laws (United States Department of Labor, n.d.b).

### **Affected parties**

The federal minimum wage “applies to employees of enterprises that have annual gross volume of sales or business done of at least \$500,00”, “employees of smaller firms engaged in interstate commerce or in the production of goods for commerce”, those “who perform duties which are closely related and directly essential to such interstate activities”, and “employees of federal, state or local government agencies, hospitals and schools, and it generally applies to domestic workers” (WHD, n.d.a., para. 15). Those employees that fall under the above are eligible to be paid a minimum of \$7.25 an hour as of 2009. However, the method of receiving minimum wage differs for employees who receive tips. Employers can pay employees who receive tips no less than \$2.13 an hour as long as that that amount, plus the amount in tips made, is equal to the federal minimum wage. Any amount that is not made in tips to meet the federal wage must be paid to the employee by the employer (WHD, n.d.a.).

Though federal minimum wage laws apply to many citizens in the United States, not everyone is required to be paid the federal minimum wage under the FLSA. Some exemptions include those under 20 years old, students, and those with disabilities.

As of the 1996 Amendments to the FLSA, employers are allowed to pay a youth minimum wage. The youth minimum wage applies to those under 20 years old and allows employers to pay applicable employees a lower minimum wage of \$4.25 an hour for a 90 calendar day period after they are first employed. The youth minimum wage does not increase with FLSA minimum wage (WHD, 2008). The youth minimum wage exception can pose a problem. Using the basic assumption of economics, businesses will make decisions to maximize profits. As a result,

employers may resort to hiring the youth for only the 90-day period where they can pay them less, saving the employer money as opposed to keeping the youth employee past the 90-day period at an increasing the hourly wage to \$7.25 an hour.

Another exemption is based on education status. Employers that hire high school students who are at least 16 years old and are enrolled in vocational education may “obtain a certificate from the Department of Labor which allows the student to be paid not less than 75% of minimum wage” (WHD, n.d.a., para. 9). Meanwhile, college student exemptions are determined by The Full-Time Student Program. The Full-Time Student Program is for full-time students who are employed by retail or service stores, agriculture, or colleges and universities. The program allows employers that hire students to “obtain a certificate from the Department of Labor which allows the student to be paid not less than 85% of the minimum wage” and work no more than “8 hours in a day and no more than 20 hours a week when school is in session and 40 hours a week when school is out” (WHD, n.d.a., para. 7).

### **Economic Implications and Criticisms**

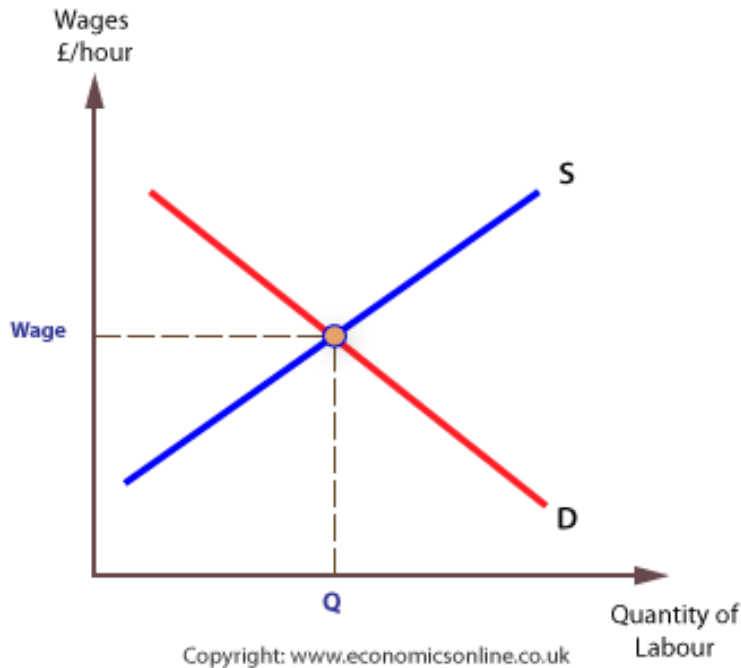
Before looking at the relationship between minimum wage and employment in the economy, it is important to understand the laws of supply and demand and how it affects the labor market.

#### **Laws of Supply and Demand**

The laws of demand show that price and quantity have an inverse relationship – as price goes up, quantity demanded goes down and visa-versa. The laws of supply show that price and quantity have a direct relationship – when price goes up, quantity supplied goes up. Together, the supply and demand curve create a market. When graphed, the point where the supply curve and demand curve intersect, market equilibrium (Q), is where the market is expected to operate. In economics, it is said that competition will always drive the market to equilibrium. So, when a price floor is created, a minimum price for a product is established, the market will never be able

to function at equilibrium. Therefore, if the demand for labor is put with the supply of labor, the labor market is created as seen in Figure 1.

**Figure 1**



*Note.* This shows the application of the laws of supply and demand to labor. Retrieved from “The Labour Market”, by *Economics Online*, n.d., ([https://www.economicsonline.co.uk/Competitive\\_markets/The\\_labour\\_market.html](https://www.economicsonline.co.uk/Competitive_markets/The_labour_market.html)).

### **Labor Market and Minimum Wage**

In creating a minimum wage, a price floor ( $W_1$ ) is created. Since the labor market is unable to reach equilibrium, complications between unemployment and the economy can arise. This means that the starting price for labor lies above equilibrium. Therefore, in regard to minimum wage and employment, if the minimum wage goes above the wage set by market equilibrium, a labor surplus is created – the demand for labor decreases ( $Q_1$ ) and the quantity of labor supplied increases ( $Q_2$ ) – and unemployment goes up. This can be seen in Figure 2.

Figure 2



*Note.* This shows how a price floor, minimum wage, affects the labor market. Retrieved from “The Labour Market”, by *Economics Online*, n.d., ([https://www.economicsonline.co.uk/Competitive\\_markets/The\\_labour\\_market.html](https://www.economicsonline.co.uk/Competitive_markets/The_labour_market.html)).

### Criticisms of Increasing the Minimum Wage

From using the basic assumption of economics, it can be seen that raising the minimum wage can have a dramatic impact on the way businesses function. As a result of a minimum wage increase, employers could hire fewer employees, decrease the number of hours their employees work, raise the prices of their goods and services to offset the new increased price of labor, and see the cost of higher wages in lower profits (CBPP, 2018). Businesses will take whatever action necessary to ensure that they will maximize profits. In addition, “those who are not laid off will reap the benefits of a higher minimum wage, but will have to work harder to make up for less staff” (Nemeth, 2020, para. 4).

Some argue that raising the minimum wage will never satisfy the need for a higher minimum wage. Those who are making a wage “higher than the old minimum wage but lower than the new rate” will ask for increased wages in order for them to be “distinguished for their peers” and “to compensate them for their skills” (Nemeth, 2020, para. 4). Raising the minimum wage will only lead for a higher demand for people to be distinguished financially from one another.

On the other hand, some believe that an increase in the minimum wage can lead to positive impacts on business efficiency. A minimum wage increase could cause businesses to operate more efficiently as employers search for more ways to improve productivity with limited labor (CBPP, 2018). A reduction of labor can lead businesses to turn to technology as a way to improve cost efficiency. An example of this can be seen in McDonald's new kiosks where customers can order their food themselves without having to order from an employee. This is a way the company is using technology to replace employees in order to reduce the cost of labor and increase profits (Speer, 2018).

Not only can an increase in the federal minimum wage affect employment, it can also affect the federal budget. The net effect of raising the federal minimum wage could cause a small decrease in budget deficit for some years, but it would not be an amount large enough to make a difference in deficits in the long run. The cost of an increased federal minimum wage causes wages that the government pays to its employees to increase and “indirectly by boosting the prices of some goods and services purchased by the government” (Congressional Budget Office, 2014, para. 21). In addition, the increase in real income for some and reduction of real income for others will affect federal spending and taxes. For example, for those who would receive an increase in real income from an increase in the federal minimum wage could also receive a tax increase and potentially a decrease in federal tax benefits (Congressional Budget Office, 2014).



However, it is important to look at case studies in the United States to confirm, deny, or add to these criticisms of minimum wage.

### **Case Studies**

Some case studies show a gradual minimum wage increase may not have a significant impact on businesses and unemployment. The [New York Time's analyzation](#) of a case study done of New York's southern border raising its minimum wage has shown that it did not necessarily increase unemployment. According to Arindrahit Dube, an economist at the University of Massachusetts Amherst, this result has been seen to resonate through other states that raised their minimum wage. Dube concluded that "up to a point, minimum wages can be absorbed without any substantial changes in employment", but lead businesses to meet the increased costs of labor by "taking a hit to profits, improving productivity or raising prices" (Smialek, 2019, para. 12). With an increase in income, it can be assumed that consumers could become inelastic as the prices of goods would proportionally increase with income. In Dube's findings, it is important to note the idea that to a certain point of increase will minimum wage not have a dramatic effect on the relationship between businesses and unemployment, but rather impact business's financial standings. If the minimum wage increase had been exceptionally higher than the base minimum wage set, it can be assumed that the results would exceed just affecting business' finances and could begin to include an increase in unemployment.

However, it is important to note why certain states raise their minimum wage. In 2016, New York and California were the first two states to pass legislation that raises their state minimum wages to \$15 an hour; since then, an additional 27 states have raised their minimum wage higher than the federal minimum wage. Only eight of those states are regularly adjusting their minimum wage in accordance with their cost of living (Kiger, 2019). This shows that only some

states are purposefully raising their minimum wage according to their data on standards of living and as a result, may see effective results.

On the other hand, some studies show that an increase in minimum wage can lead to an increase in unemployment. According to the Congressional Budget Office, increasing the minimum wage could lead to an increased income that would allow said employees to rise above the poverty level or the elimination of some low wage jobs resulting in unemployment and a decrease in income (Congressional Budget Office, 2014). Though an increase in minimum wage can lead to increased income, it could also make the income gap much wider.

In addition, some believe the increase in unemployment can lead to an increase in poverty. The 1968 federal minimum wage increase, when adjusted for inflation, reached its peak in 1968 at \$1.60 an hour (equivalent to \$11.53 an hour in 2019). According to Kiger (2019), though federal minimum wage was higher relative to living costs, “poverty of that period tended to be more of an issue of unemployment, rather than low-wage working poverty” (para. 24).

This leads to the second criticism economists have on increasing minimum wage – the misconstrued idea that a higher minimum wage can reduce poverty. A [study](#) done in 2010 by Joseph Sabia, of American University, and Richard Burkhauser (2010), of Cornell University, found that the minimum wage increase between 2003 and 2007 has had “no effect on state poverty rates” as most employees affected are not below the poverty level (p. 612). A minimum wage increase may not help those who are in poverty as it could widen the gap between those in poverty and those who are better off.

### **Conclusion**

The minimum wage, while created in part to meet the needs of labor regulation, has also caused more problems than what was originally expected since it was establishment in the

FLSA in 1938. The process for minimum wage to change at both the federal and state level is a complex. Though there have been changes in minimum wage in order to adjust for inflation and meet the cost of living, there is still an ongoing demand for an increase.

The minimum wage is therefore a catch-22. An increase, not due to inflation, could lead to increased business efficiency and possible increased household incomes. However, it can also lead to unemployment, a wider gap between poverty and those better off, and higher prices. Meanwhile, if minimum wage is not increased with the cost of living, unemployment may be kept at bay, but will lead to unsatisfied employees and an increased income gap. Therefore, the justification for an increase in minimum wage will always be an ongoing battle, as there are many factors to be considered before adjusting it.

The conclusion can be made that increasing minimum wage now will not satisfy United States citizens in the long run. This is because the need for an employee to be distinguished from their coworkers will not be eliminated through an increased minimum wage, as they will find themselves in the same position years after their demands for an increased minimum wage are met. Rather, it will just lead to the demand for another increase in the minimum wage or salaries in order to make up the difference.

## References

- Center on Budget and Policy Priorities. (2018, December 19). *Policy Basics: The Minimum Wage*. <https://www.cbpp.org/research/economy/policy-basics-the-minimum-wage>
- Cole, P. (2016, June 24). *Minimum Wage and More: The Law That Changed American Labor*. Time. <https://time.com/4376857/flsa-history/>
- Congressional Budget Office. (2014, February 18). *The Effects of a Minimum-Wage Increase on Employment and Family Income*. <https://www.cbo.gov/publication/44995#section4>
- International Labour Organization. (2015, December 3). *1.1 Definition and Purpose*. [https://www.ilo.org/global/topics/wages/minimum-wages/definition/WCMS\\_439072/lang-en/index.htm#1](https://www.ilo.org/global/topics/wages/minimum-wages/definition/WCMS_439072/lang-en/index.htm#1)
- Kiger, P. J. (2019, October 18). *Minimum Wage in America: A Timeline*. HISTORY. <https://www.history.com/news/minimum-wage-america-timeline>
- Krulick, A. (n.d.). *Minimum Wage*. Debt.org. <https://www.debt.org/jobs/minimum-wage/>
- Kurtz, A., Yellin, T., & Houp, W. (2019, April 9). *The US minimum wage through the years*. CNN. <https://www.cnn.com/interactive/2019/business/us-minimum-wage-by-year/index.html>
- Nemeth, M. (2020, January 16). *Why the Minimum Wage Is so Bad for Young Workers*. Intellectual Takeout. <https://www.intellectualtakeout.org/article/why-minimum-wage-so-bad-young-workers/>
- Sabia, J. J., & Burkhauser, R. V. (2010). *Minimum Wages and Poverty: Will a \$9.50*

Federal Minimum Wage Really Help the Working Poor? *Southern Economic Journal*, 76(3), 592–623. doi: 10.4284/sej.2010.76.3.592

Smialek, J. (2019, November 13). *As Push for Higher Minimum Wages Grows, New York Offers a Test Case*. The New York Times.  
<https://www.nytimes.com/2019/11/13/business/economy/minimum-wage-new-york-pennsylvania.html?searchResultPosition=11>

Speer, M. (2018, August 9). Why Is McDonald's Moving Toward Kiosks? Retrieved from  
<https://www.forbes.com/sites/quora/2018/08/09/why-is-mcdonalds-moving-toward-kiosks/#2004d4f56681>

“The Labour Market”, by *Economics Online*, n.d.,  
 ([https://www.economicsonline.co.uk/Competitive\\_markets/The\\_labour\\_market.html](https://www.economicsonline.co.uk/Competitive_markets/The_labour_market.html)).

United States Department of Labor. (n.d.a). *Exemptions*.  
[https://webapps.dol.gov/elaws/whd/flsa/screen75.asp?\\_ga=2.88221531.1305808700.1586884228-1434752295.1575938367](https://webapps.dol.gov/elaws/whd/flsa/screen75.asp?_ga=2.88221531.1305808700.1586884228-1434752295.1575938367)

United States Department of Labor. (n.d.b). *What is the Federal Minimum Wage?*  
[https://webapps.dol.gov/elaws/faq/esa/flsa/001.htm?\\_ga=2.70151506.356282454.1586028649-1434752295.1575938367](https://webapps.dol.gov/elaws/faq/esa/flsa/001.htm?_ga=2.70151506.356282454.1586028649-1434752295.1575938367)

Wage and Hour Division. (n.d.a). *Questions and Answers About the Minimum Wage*.  
 U.S. Department of Labor. <https://www.dol.gov/agencies/whd/minimum-wage/faq>

Wage and Hour Division. (n.d.b). *Wages and the Fair Labor Standards Act*. U.S.  
 Department of Labor. <https://www.dol.gov/agencies/whd/flsa>

Wage and Hour Division. (2008, July). *Fact Sheet #32: Youth Minimum Wage - Fair*

*Labor Standards Act.* U.S. Department of Labor. <https://www.dol.gov/agencies/whd/factsheets/32-minimum-wage-youth>