Modern Economy, 2022, 13, 1397-1408
https://www.scirp.org/journal/me
ISSN Online: 2152-7261
ISSN Print: 2152-7245

# Analyzing the Socio-Economic Impacts of the US Federal Minimum Wage

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**How to cite this paper:** Wang, Z. L. (2022). Analyzing the Socio-Economic Impacts of the US Federal Minimum Wage. *Modern Economy, 13,* 1397-1408.
https://doi.org/10.4236/me.2022.1310075

**Received:** August 2, 2022
**Accepted:** October 28, 2022
**Published:** October 31, 2022



## Abstract

With United States president Joe Biden announcing plans to raise the federal minimum wage to $15 an hour, conversations surrounding minimum wage laws have resurfaced yet again as businesses and policymakers look to get ahead of its effects on the economy. This paper will analyze the economic and social impacts of the US federal minimum wage by drawing on economic models and empirical data from sources such as the Congressional Budget Office and Bureau of Labor Statistics. Various studies have shown that raising the minimum wage would result in large-scale unemployment effects, severely hurting the economy in the midst of the COVID-19 recession. Firstly, minimum wage policies fail to combat poverty and instead induce cost-push inflation, reducing real wages. Secondly, many contract and self-employed workers are not covered by minimum wage regulations at all. Thirdly, by directing those at the lowest end of the wage spectrum into the ranks of the unemployed, minimum wage laws have an unfairly disproportionate effect on the impoverished, thereby exacerbating income inequality. Finally, from a social perspective, minimum wage policies violate workers' freedom of contract by interfering with their employment seeking process, and the existence of minimum wages can weaken workers' negotiation power in wage bargaining. This weakness is especially evident when considering that there are many other alternatives in safeguarding workers' rights such as workplace safety laws and trade unions. In light of these negative impacts, this essay warns policymakers to not be too optimistic towards the minimum wage and encourages governments to seek other alternatives to protect workers' rights and secure higher wages. By analyzing the potential drawbacks of the minimum wage, this paper addresses a gap in the existing literature, which mainly focuses on the benefits of the policy. Therefore, not only will this paper contribute to existing work in the field of labor economics, it also provides a more holistic, well-rounded perspective of the federal minimum wage.

## Keywords

Minimum Wage, Federal Minimum Wage, Unemployment, Poverty, Inflation, Real Wages, Income Inequality, Freedom of Contract, Trade Unions, Workers' Rights

## Structure

This paper is divided into six parts. The organization is as follows:

1) Introduction;
2) Literature Review;
3) Methodology;
4) The effect of the minimum wage on unemployment;
5) Effects on the minimum wage on inflation;
6) The minimum wage and workers' rights;
7) Alternatives to the minimum wage;
8) Conclusion.

You may find direct references in the footnote section at the bottom of each paper, and other citations or relevance listed in the bibliography at the end of the paper.

## 1. Introduction

The SARS-CoV-2 strike on the United States had no doubt cast a formidable shadow over the American public as the turbulent of economic hardship blew. One appealing idea is to increase the federal minimum wage to fight economic instability and reverse plummeting levels of economic activity. The fundamental principle behind such regulations is simple—raising the minimum wage means a higher income, or GDP per capita, and will therefore boost people's spending ability (Congressional Budget Office, 2021a; Kindersley, 2012). The approval of legislature to increase the minimum wage to $15 in states such as California and Massachusetts made such claims more attractive, as an uptick in expenditure is expected to solve poverty, increase general welfare, and boost incentives for American workers (The Argument, 2021). Hence, when officials announced Joe Biden's decision to set the minimum wage for federal contractors to $15 an hour in 2022, moving the matter from state to federal level, American citizens rejoiced (The Argument, 2021). At first glance, such proposals may seem reasonable. However, it should be noted that he decided to adopt a blindly optimistic approach, neglecting to mention risks such as those headlined in a recent report conducted by the Congressional Budget Office (CBO). In this essay, the downsides of minimum wage regulations are discussed in terms of the socio-economic well-being of the United States, and it is argued that not only should we not raise the minimum wage, but we should also completely abolish this policy since it contributes to unemployment, inflation, poverty, and loss of civil rights.

Before continuing, it should be noted that this essay will only discuss minimum wage regulations imposed at a federal level. In current times, state level minimum wages vary from $14 to $7.25 due to differences in cost of living, economic activity, and culture (Neumark & Wascher, 2008). Due to this lack of uniformity, it is impossible to determine the totality of the effects of minimum wage regulations from state level implementation (Lunt, 2020). For instance, when such state legislation is first set up, they may conform to four completely distinct simulation models and in 2021, roughly half of the states increased their minimum wage while others remained unchanged, demonstrating the disorganized nature of state minimum wage implementation (Draeger, 2021; Employment Policy Institute, 2019). This phenomenon cannot be adequately addressed here; whereas the federal minimum wage, based on a national level of which all states must have equal to or higher than, should be evaluated instead.

## 2. Literature Review

To begin with, the neoclassical economic model of labor supply and demand suggests that the existence of a minimum wage creates unemployment, acting as a price floor that creates a surplus of labor. Founded upon the theoretical basis of competitive market and reserved attitude of minimum wagecomplied with individual utility (Brožová, 2018; Ratzel, 2009), this model predicts that the increase of minimum wage will result in firms cutting employment (less quantity of labor demanded) and substituting highly skilled labor with less skilled labor whose wages have risen (Giuliano, 2009).

However, among different scholarly articles, many tend to go on a different path and agree that the policy could cause salary raises across all income ranks if the threshold increases. Theoretically, this is due to companies wishing to adopt financial benefits to remain competitive in attracting and recruiting high-quality workers in the job market; business owners would try to maintain previous relative wages between employees in order to avoid friction and jealousy between employees (Ghadi, 2018), as assumed by a recent 2021 study by Mokhiber et al. (2021) of which approximates that a projected 35 million workers would witness an upsurge in pay despite only 247 thousand people living on the minimum wage in 2020 (Bureau of Labor Statistics, 2020). This is also in line with the Stiglitz-Shapiro model of efficiency wages, which suggests that workers can choose to work hard or "shirk" (Krueger & Summers, 1988). Therefore, companies would increase wages to avoid workers from slacking off. By this means, reducing or restraining the minimum wage would cause workers to potentially lose their safeguard for the right of a living wage and therefore further up the earnings distribution. They argue that minimum wages combat rampant levels of wealth inequality today (Saez, 2020) while conserving moderate social stratification in salaries (Lin & Yun, 2020) that allow for innovation and competition. In turn, these wage improvements for workers increase their disposable income and stimulate consumer spending, thereby benefiting businesses and spurring economy activity (Reddaway, 1964). Moreover, since employees at the lower end of the pay scale have a relatively greater marginal propensity to consume (MPC), aggregate consumption is boosted by minimum wage spikes that enhance the purchasing power of the lower classes (Carroll et al., 2017).

Spontaneously, most arguments that offer positive insights into increasing minimum wage seem to opt out the discussion of unemployment. In some cases, the hope of shortening income inequality is even portrayed to shed shade over the idea of unemployment, or to focus on the disposable income the workers may bring to the society which may or may not lead to economic prosperity (Cordato, 2018). But is increasing the minimum wage indeed this efficient and effective? My research findings suggest otherwise.

## 3. Methodology

To analyze the potential drawbacks of the minimum wage, this essay utilizes publicly available data from government sources such as the Congressional Budget Office and data bases such as Eurostat. Such empirical data are then synthesized and collated together to provide a more holistic view on the minimum wage.

Through the extraction and evaluation of existing surveys, questionnaires, polls, research, authoritative data and expert opinion, this article illustrates the financial outcomes of raising minimum wage not from a theoretical and pragmatic perspective, but a practical, incorporated insight. Along with the citation and examination of laws and sociological ethics over protection for the working class, the paper uncovers the ultimate truth behind the hope of decreased inequality—the loss of workers' rights and freedom and the increase of poverty that comes forth as an exchange for an optimistic hope. In addition, this study takes into account of the various factors such as technological advancement, measurement of the indexical threat of inflation that could potentially not only further increase unemployment but also widen income inequality, and the nature of this regulation to exclude certain self-employed or seasonal workers that would all lead to disappointing consequences. By comparing and contrasting the United States economy with other such as those in the EU and dissecting past examples, this research reveals assumes the empty promise of pushing up income level for the entire society and addresses a significant gap in the literature in regard to the potential drawbacks of the minimum wage.

While most research tend to emphasize on the benefits of raising the U.S. federal minimum wage to $15 per hour, this paper analyzes the downsides of increasing minimum wage and encourages governments to seek other alternatives to protect workers' rights and secure higher wages.

## 4. The Effect of the Minimum Wage on Unemployment

### 4.1. Empirical Evidence from the US

As a matter of fact, the results of the CBO report *The Budgetary Effects of the*

*Raise the Wage Act of* 2021 suggest that raising the federal minimum wage to $15 results in disastrous consequences. According to the report, if the national minimum wage climbs to $15 per hour in 2025, employment will be reduced by 1.4 million workers. Even if the total population moving out of poverty—0.9 million—are considered, a large gap of 0.5 million will receive absolutely no income, which may force them into poverty and, more importantly, expand unemployment (Congressional Budget Office, 2021a). The underlying reason for such a change is rising labor costs. A survey consisting of 1213 businesses as well as human resources professionals found that 38% employers who currently offer minimum wage would dismiss their employees if the minimum wage was raised to $10. Even worse, more than half said they would decrease hiring levels (Kast, 2014). In other cases, firms of high factor mobility would switch to alternative capitals and high-tech automated processes, replacing workers with self-efficient machines to reduce labor costs (Woodman, 2014). Moreover, firms would plan to move out of the country to seek cheaper labor, thus causing outsourcing of jobs and stagnation of economic growth. A 2014 study conducted on 400 United States Chief Financial Officers (CFOs) discovered that 70% of the CFOs would "increase contracting, outsourcing, or moving actual production outside the United States" once the minimum wage clung to $10 an hour (Washington Free Beacon, 2014). Yet another survey conducted by Statistic Brain Research Institute revealed 2,382,000 US jobs were outsourced in 2015 with a massive 44% of companies attributing this to cost control (Statistic Brain Research Institute, 2017). We are forced to arrive at the conclusion that an inverse relationship exists between minimum wage and employment.

### 4.2. Empirical Evidence from the EU

Despite supporters' insistence that minimum wage policy would benefit employees, an assessment of countries with similar economic systems further reveals the weakness of these claims. A recent study by Hanke (2014) showed that 21 EU members with minimum wage regulations have an average unemployment rate of 11.8%, about 1/3 higher than the 7 EU countries without a minimum wage (7.9%). In addition, as indicated in the graph below, countries in the EU holding minimum wage policies tend to have at least 2% less youth employment compared to that of the countries without minimum wage; at its peak, there can be a difference as high as 8% amongst the countries, shown through the predominant gap between the two trends, suggesting a strong, positive correlation between minimum wage and unemployment. In light of this relationship between unemployment and minimum wage, it is criminal to continue to preserve such a harmful policy (**Figure 1**).

## 5. Effects of the Minimum Wage on Inflation

### 5.1. Effects of the Minimum Wage on Inflation

It is true that many minimum wage policies are introduced with hopeful aims of

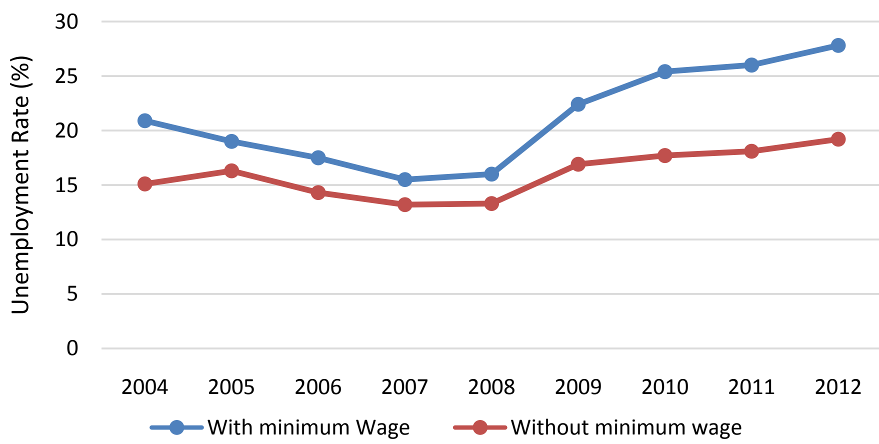


**Figure 1.** Average youth unemployment rate of EU countries with and without minimum wage (Hanke, 2014).

reducing poverty, but does minimum wage really redistribute income on a fairer and efficacious basis? Research has shown that minimum wage regulations increase the proportion of families in poverty (Neumark et al., 1999). The net effect of higher minimum wages will be most unfavorable to impoverished households as firms strive to cover the amplified labor costs. Greater amounts of the consumers' income are requested in exchange to purchase the same ordinary items (Grennes & Strazds, 2015). This makes acquiring essential goods harder for the poor, as the price increase once again suppresses their purchasing power. *Inflation* is the ultimate term used to describe the spike in the general price level and the chain effects presented above (The Investopedia Team, 2021; Oner, 2021). In this case, wage-push inflation is imposed on consumers as they pay for the increased labor costs producers face (Tracy, 2020; US Legal Incorporation, 2021; Creswell, 2021). For example, studies found that restaurants would transfer almost 100% of their increased costs of labor on to their customers, forcing them to pay higher prices and thus ratcheting up the general price level, leading to inflation (Aaronson & French, 2013). Since the minimum wage fails to achieve its objective of helping the impecunious—effectively stagnating or even degrading their standards of living instead of raising them—his policy throws a noxious and fecklessly ironic shadow upon the impoverished. To eliminate the chances of such a catastrophe occurring, the minimum wage should be abolished.

### 5.2. Effects of the Minimum Wage on Income

Although the primary purpose of minimum wage proponents is to raise the income of individuals, the median wages in countries without minimum wage virtually remains high across the globe. In fact, seven of the countries in the top 20 ranking for annual median wage do not have a minimum wage regulation, and these countries make up 41% of the 17 highest median wage countries in the world. Considering the number of countries with minimum wage regulations that fall outside of the top 20, it seems groundless to assume that the minimum wage regulation secures a high- and competitive-income level (**Table 1**).

Table 1. List of countries without minimum wage by employment rate (the proportion of employed people between from ages 15 to 64), 2019.

| Country | Annual Median Wage | Global Rank |
|---|---|---|
| Iceland | $72,850 | 7 |
| Switzerland* | $85,500 | 4 |
| Sweden | $55,840 | 12 |
| Norway | $82,500 | 5 |
| Denmark | $63,240 | 9 |
| Austria | $51,300 | 15 |
| Finland | $49,580 | 17 |

Adema et al. (2019); Oecd (2021).

### 5.3. Limited Coverage of the Minimum Wage

Even if we argue that minimum wage provisions do cover most low-wage workers, an additional issue is that such policy mercilessly disregards the self-employed, business owners, and certain seasonal workers (McClure, 2015). In particular, workers in the agricultural industry are excluded, as their income is derived from the raw materials they produce by their own hands. This works against the ideology of rendering an increase in real income as their decreasing general income and stagnating disposable income levels cause their spending ability to decrease with inflation at a rate greater than what is experienced by other laborers (Congressional Budget Office, 2021b). With minimum wage phasing in, the cumulative budget deficit over the 2021-2031 period would skyrocket by $54 billion, further exerting pressure on the market and decreasing the fiscal and monetary power of the government to produce more policies that directly solve, or relegate, poverty. Limitations, as well as negative spillovers, of minimum wage regulation have now become clear in an unexpectedly scathing way. Consequently, the abolition of the minimum wage policy is necessary.

## 6. The Minimum Wage and Workers' Rights

### 6.1. The minimum Wage and Freedom of Contract

On the other hand, shifting the focus to the interests of workers, proponents believe that minimum wage policies undeniably "protects workers from exploitation", guaranteeing fundamental, ethical rights of the laborers. However, the one right that is frequently ignored is workers' freedom of contract. In the sphere of contract law, freedom of contract—that is, workers' rights to bargain and create the terms of their agreement according to their will without outside interference (e.g. the government)—is a core principle (Cornell Law School, 2021). The minimum wage policy presents an undue burden on the freedom of contract laws contained in the contract clause of Article I, Section 10 of the U.S. Constitution by introducing an unavoidable surge in the price of labor (Merriam Webster, 2021). A 2016 conference paper published in Vilnius University (Davulis et al.,

2016) analyzed the predominant role of minimum wage played in attacking the freedom of contract,

> "Taking into account the historical perspective, the point of view of ethics and morals, economic grounds, and also political and sociological aspects, minimum wage limits freedom of contract on a core term such as the price of labor, hence its desirability, under such extreme, should be carefully re-examined."

### 6.2. The Minimum Wage and Salary Negotiations

As a result of limitations introduced by minimum wage regulations, workers lose their ability to offer attractive deals and enter potent negotiations. In other words, it is less legitimate for unemployed workers to negotiate wages based on their will during job interviews. Less skilled workers are more financially unstable and may want to strategically lower their wages to attract secure employment. However, according to minimum wage laws such attempts are more likely to be immediately deemed illegal. As a result, employers will no doubt choose the more productive or highly qualified laborers to get the most bang for their buck.

## 7. Alternative to the Minimum Wage

Minimum wage regulation is a weak solution to safe-guard worker's interest when compared to other alternatives. For example, there are other trenchant routes to providing full protection against exploitation by employers without violating any employee rights. To these ends, occupational safety and health assurance enacted in 1970 includes a "General Duty Clause" that prohibits any workplace practice that represents a clear risk to workers (Pazos, 2016; National Institute for Occupational Safety and Health, 2020); company-funded health insurance regulations passed in 2010 requires that employers with 50 or more full-time workers offer them a minimal level of health insurance or pay a substantial penalty (Internal Revenue Service, 2021); whistleblower protectionist policies consist of acts that directly safeguards those who highlight violations of environmental law and uncover unlawful manufacturing policies (US Department of Labor, 2022). Other examples such as trade unions are founded by the people and legalized by the government for workers' rights and improved working conditions (Britannica, 2019; Pinto & Michaelis 2014; Walters & Mishel, 2003). These federal policies not only shield employees against unfairness and exploitation but also provide general employment interests, thus creating incentives for the unemployed to actively seek work without restraining the attractiveness and the bargaining power of the workers themselves.

## 8. Conclusion

Overall, despite its extravagant economic aims highlighted by current literature, expanded minimum wage policy at the federal level would not only fail to fulfill its primary goals regarding accretion of general income, downscaling of national poverty, and safeguarding of workers' rights, but it also fosters negative viral outcomes that will inevitably contribute to economic recession, including unemployment, inflation, and constrained worker liberty. Accordingly, abolishing the minimum wage instead of promoting and raising it is inarguably and inevitably the wisest consecutive decree President Biden should issue. Only then can we take a holistic approach to reduce economic deficiencies, promote heightened circulation of money, and bring about the growth in the national GDP that the entire country wishes to see (Fernando, 2021).

## Future Recommendations

The findings of this paper will have significant implications for policymakers and researchers. Firstly, contrary to existing literature, this paper illustrates the numerous economic drawbacks of the minimum wage, such as unemployment, cost-push inflation, and income inequality. In addition, this paper also explored how minimum wage laws violate the principle of freedom of contract by interfering with wage negotiations between employers and workers. Therefore, it is recommended that policymakers initiate legislation to abolish the minimum wage. To prevent abrupt disruption and allow the economy to reach stable equilibrium steadily, governments could gradually reduce the legal threshold with a long-term plan to dismantle the minimum wage. In addition, this essay also highlighted numerous alternatives to the minimum wage, such as trade unions and workplace safety laws. Governments are advised to turn towards these policies to improve workers' welfare, rather than continuing to adopt and raise the minimum wage.

For scholars, more holistic research needs to be conducted on the minimum wage, especially its potential drawbacks, given that current literature is slanted towards the positive aspects of the policy. For instance, the impact of minimum wages on unemployment should be examined closely, as contemporary studies yield inconsistent and conflicting results at best.

## Conflicts of Interest

The author declares no conflicts of interest regarding the publication of this paper.

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