The Legal Minimum Wage

Would An Increase In The Min. Wage Cause Unemployment?

By Mike Curtis 9/26/15

Ever since it was proposed and enacted in 1938 during the Great Depression it has been assumed by many that the Legal Minimum Wage causes unemployment. Today there are not only those who argue that it causes unemployment, but others that argue the opposite — that every increase in the Min. Wage increases the buying power of workers, and therefore, by increasing the demand for products and services, it increases the number of jobs. The following is an analysis of these arguments and a proposal.

The Min. Wage has been raised from time to time. In 1968 it was $1.60 per hour and today it is $7.25 However, inflation has off set those gains and today the Min. Wage buys less than it did in 1968. In 1968, the Min. Wage would have bought the same amount as $10.34 would have bought in 2012. So, in terms of buying power, the Min. Wage fell by $3.09. During those same years, the productivity of the American worker increased by an average of more than 100%.

Although a very small percentage of workers are paid exactly the Min. Wage, every increase in the Min. Wage, increases the wages of all workers by the same amount. When the Min. Wage went from $6.55 to $7.25 those who were already making $7.25 would have lost the incentive to work harder and smarter than those who's wages were just raised to the same amount. So, their wages went from $7.25 to $7.95 to maintain the incentive. In principle, even those making $100 per hour would have gotten a 95 cent per hour raise. Since it affects all workers it is an extremely important political decision.

An increase in wages is an increase in the cost of production. Therefore, an increase would likely mean that some prices would go up and the volume of some goods and services would fall. Pizza delivery might be one of the first to do less business. However, increased wages might also mean that even more people will buy and pick up their own pizza increasing the number of jobs as cooks in the pizza parlors. Because the laws of production and distribution are sufficiently complicated and not generally in our conscious minds, I will start there.

The Factors of Production

All products result from labor (mental and physical) applied to the natural resources — referred to here as: land. First, tools, machines, and buildings are produced to give labor a greater efficiency, and those, along with products which have not yet reached the final consumer, are referred to here as: capital.

The Laws of Distribution

Where land is free and labor is assisted by capital, wages will consist of the entire product minus what is necessary to induce the storing up of capital. Where land is owned, wages will consist of the entire product that could have been produced on the best land that is free, minus what is necessary to induce the storing up of capital. Individual wages will depend on the abilities and productivity of each worker.

The owners of capital (as inferred from the law of wages) will take as interest whatever portion of a product would have been necessary to induce the storing up of capital on the best land that is free.

The owner of any particular parcel of land will take as Rent, the difference between what labor and capital produce on their particular parcel of land and what that labor and capital could have produced on the best land that is still free.

Without free land

When there is no free land that will yield to labor and capital more, then, in the free market, wages of the least productive (educated & skilled) workers will fall to an amount below which they would get hungry and weak and they would produce less. The more productive workers (with greater skill & knowledge) get paid only what is necessary for the supply of their skill and knowledge to meet the demand. Employers bid against each other with higher pay to get superior workers; higher pay induces more workers to learn the more difficult jobs; more superior workers come forth increasing the supply; the wages of superior workers fall. However, the difficulty of learning and performing the superior jobs limits the supply and sets the rates of pay for every level of skill and occupation.

Without free land, the owners of capital will still take that portion of any product that is necessary to induce the storing up of capital, but, it will be less, because nature's productive forces are no longer longer accessible.

When interest rates are artificially lowered by lending new money at lower rates (as was done in the recession), the tendency shifts. Because money and capital are interchangeable, the return to capital falls as well and less people invest in the ownership of capital. However, landowners borrow money and buy capital. The capital increases productivity. Landowners get a smaller return from the capital than before, but, because it increases productivity, they get a greater income from their land.

Without a free-land opportunity, the tendency is for all increases in productivity (inventions, new technologies, and additions to the infrastructure) to be taken by the owners of land and other monopolies. The government takes a portion of this in taxes.

The Legal Minimum Wage requires a larger portion of the wealth produced to be given to the workers who produced it. An increase in wages is paid at the expense of rent. This is clear in the case of a company that owns all its land and capital. If the workers get an increase in wages, the landowners get less income from their ownership of the land. The return to capital (buildings, machines, inventory) is determined by what you can borrow capital or money for without risk, whichever is less. Therefore, an increase in the Min. Wage will reduce rents. But, since land is not produced, it will not result in any less land. Wages will go up, and the rental and selling value of land will go down.

Now, it gets complicated. If you don't own the land and buildings on which your business is conducted, you probably have a long term 5 or 10 year lease. When the Min. Wage is raised it doesn't reduce the terms of the lease, so unless you are an exceptional business man, you may default, and this can result in bankruptcy and unemployment for your workers. If you have just bought a parcel of land and incurred a mortgage, the price you paid was likely based on the current level of wages. An increase in wages will not lower your mortgage payments. Therefore, you may not be able to maintain a profit, and in that case you will go bankrupt and lay off workers increasing unemployment.

Of course, after a period of inactivity the next business person who signs the lease or buys a parcel of land will only offer to pay what they can based on the new higher wages, and business and employment can go on there after.

The Min. Wage is $3.09 cents below what it could buy in 1968, and this is obviously part of why more welfare has been needed and more people are living in poverty. $10.34 would enable the Min. Wage to buy what it did in 1968. Many people are proposing $15 per hour, which is about half way between the buying power of 1967 and what the Min. Wage would be if it had been increased at the same rate as the average worker's productivity ($21.72 per hour). It has also been proposed that the Min. Wage be indexed to the cost of living in each region of the country. This too may have merit, since the goal is to provide a living wage.

The cost of housing

Because there is a shortage of affordable housing for low wage workers, it is a bit like musical chairs. People with the lowest incomes bid whatever they can afford, so they won't be homeless. Only an ample supply of public housing will create an alternative to the free market, and keep the price of free market housing from gradually taking all the increase in the Min. Wage.

Exactly how quickly the Min. Wage could be raised to compensate for inflation, let alone productivity, without causing short term unemployment, is probably not known. Increasing the Min. Wage may require gradual steps. It may be unconstitutional to legislate the option to renegotiate leases where people are employed, but that would be a big help in preserving jobs. For those who have purchased land, there may be no way out, other than inflation, which cancels debt, but it robs all savers and investors of productive capital, which in my opinion should never be resorted to.

For those reasons, I think it would be difficult to raise the Legal Min. Wage precipitously without some countervailing force.

Increasing the Min. Wage will create more Jobs

As for the idea that increasing the Min. Wage will increase the buying power of workers and the increased demand for goods and services will create even more jobs, I doubt it.

Certainly it will lower land rent and the selling price of land. And, assuming that the workers then demand more goods and services than the landowners did, it could increase the activities of some existing factories and business that were not operating at full capacity. However, where there are long term leases or a mortgage, and the facilities are operating at full capacity, how could an increase in the Min. Wage increase productivity enough to compensate for significantly higher wages? Jobs are created by making land available for production. How will raising the Min. Wage get people to sell or put to use their valuable unused and under used land — which is necessary to create jobs?

Agreed, high-wage countries have much higher rates of employment. However, rather than employment being created by high wages, both could result from deterrents to land speculation. Even in countries with a high legal minimum wage, deterrents to land speculation could be (and in my opinion are) the reason for high rates of employment. If rates of employment could be increased by raising the Min. Wage, the Min. Wage could simply be increased until there was full employment. No other incentives would be necessary to encourage the use of land.

Shifting Taxes To the Rental Value of Land

Before I propose an immediate intervention that raises the Min. Wage, I would like to explain why a shift of all taxes to the value of land throughout the country would create full employment, raise wages, and end poverty.

Taxes now total about a third of the nations output. By shifting all taxes to the rental value of land, it would encourage people and business to hold the smallest amount of land they could use, and produce as much as possible on it. No penalties would be levied for the erection of buildings, but there would be a great expense for those who held on to valuable land and did not put it to use. The tax on the rental value of land would have to be paid even if the land were vacant or idle and there was no income out of which to pay it. There would simply be no reward for holding unused and underused land for future use or sale.

Under these incentives the most valuable land would be developed to its greatest potential. People would migrate toward the cities and suburbs. They would not be crowded like the slums of Harlem where families often share a unit, but in what is thought of as the standard of Park Avenue where large high-rise apartment buildings offer spacious living and a shared view. Although each apartment is spacious, the density per acre is far greater than Harlem. With modern technology high rise buildings give us the potential to house more people per acre in spacious living than even the phenomenal crowding of Chinatown, San Francisco.

By the same incentives, the best commercial, industrial, and mineral lands will be put to their most productive uses. As labor and capital migrate in the process of maximizing their efforts on the best land, the demand and the value of the least productive land will fall. Soon, within 50 or 100 miles of every city, there would probably be land without value. It would be good for building houses or growing crops. It might even support some small business, but other land would be so superior, so much more in demand, that it would have no rental value at all. It could be used without the payment of rent. Having free land available to everyone to live and work on would deliver high wages for everyone — just as it did in past centuries when America had a free land frontier. Not that very many people would set up a homestead or become a farmer, but no one would work for someone else, unless they were offered at least as much as they could have produced working for themselves where the land was free.

Those who held the superior land would fund the costs of government by paying rent for the land they held. Every increase in productivity would, as it does now, increase the rental value of superior lands and provide more revenue for the increasing needs of society. Every increase in productivity would increase the amount that could be produced where the land was free — just beyond the land that was economically demanded and valuable. Therefore wages would go up. Every increase in productivity would increase the returns to capital — buildings, machinery and products in the course of exchange. No one would lend their capital to some one else unless they were offered more than their capital would yield where the land was free.

Under these conditions, every increase in the population would permit greater divisions of labor and greater economies of scale. It would increase wages and the return on productive investment. And, it would increase the rental value of land, which funds our infrastructure, police, defense, education, healthcare, welfare, and the future needs of society. Under this arrangement, every increase in the population will increase the quality of life for every person in the country. And it will continue until we reach the point of diminishing returns. In short, labor and capital will enjoy whatever they produce by making use of the natural opportunities that are freely available to everyone. And that value, which represents the advantage of superior opportunities, will be collected, used, and shared for social purpose.

A first step

While efforts are made to shift all taxes to the rental value of land throughout the United States, we can also advocate a raise in the Legal Min. Wage to $10.34 per hour immediately. This will make up for inflation.

Second, we can advocate an Increase the number of government owned public housing units and make them available for all those working for the Min. Wage. The charge for those housing units could be only the cost of construction times what the government pays in interest on bonds, plus the expense of maintenance and management. That way, the increase in wages will not dissipate with the increase in the cost of housing.

Third, local governments can, independent of the state and federal government, exempt buildings from the real estate tax and increase the tax on the value of land to generate the same revenue. That will force a considerable amount of land that is suitable for employment or housing on to the market and create enough jobs to compensate for any that would have been lost because of the increase in the Legal Min. Wage. Existing businesses and homeowners that have already put their land to good use will pay less.

Fourth, the Legal Min. Wage should be indexed to increase at the same rate as productivity. It could be linked to the Bureau of Labor Statistics' per person increase in the productivity of U.S. Workers each year. It might even be possible to increase it a little more each year to catch up with the increases in productivity since 1968. The important thing is that wages would increase at the same rate as productivity. Land leases and land prices would be agreed upon with the full knowledge that wages will rise with productivity. Therefore, future increases in wages would not cause unemployment.