**Why the Next President Should Raise the Minimum Wage**

by Roger Lowenstein, *Fortune*, February 29, 2016

**It Helps Higher-income Workers, Too.**

Economic inequality is the looming issue of the 2016 campaign. The presidential debates have focused on personalities and inflammatory topics like immigration, but the underlying cause of voter frustration is the lack of wage growth.

Bernie Sanders has been the only candidate to focus on inequality, and so far no major policy proposal has emerged on either side to address the issue. But if there’s a single policy idea that could galvanize voters, it could be the call to hike the federal minimum wage, now a paltry $7.25 an hour.

Sanders backs a drastic leap to $15; Hillary Clinton would go to $12. The top GOP contenders oppose any increase at all. Sen. Marco Rubio, for instance, has called the prospect of raising the minimum wage “a disaster.”

Polls, however, overwhelmingly support an increase. Fourteen states hiked their minimums on January 1 (California and Massachusetts led the pack at $10 an hour). Meanwhile, the federal minimum hasn’t moved since 2009. Adjusted for inflation, it is lower than in 1968. A half-century is a long time to wait for a raise.

Under present law, people who work full-time can still fall short of the basic necessities of life. A fulltime mother of two who worked 40-hour-weeks at the federal minimum would gross $15,080 a year–well below the poverty line.

Opponents say hiking the minimum wage would be fruitless and perhaps cost jobs. But while their arguments shouldn’t be taken lightly on balance, though, the critics are wrong. There is a strong economic and moral case for a slow and steady increase.

The reason free-market arguments against the minimum wage fail—at least for moderate increases—is that the labor market does not behave according to the classic supply-and-demand model taught in Economics 101.

If labor markets were simply guided by the invisible hand, unemployment would not exist. In tough times, firms would cut wages rather than lay off workers. This is how the market in hamburgers works. McDonald’s doesn’t stop selling Big Macs in a recession; it lowers their price.

But employers do not cut the price of labor. As Arthur Okun, the economist and Lyndon Johnson adviser, explained, labor markets are governed by an “invisible handshake”—an implicit contract between firms and employees. Firms are reluctant to cut wages owing to an unspoken obligation to their workers. Even if they could find and retrain new workers (a costly business) willing to accept less, they are fearful of upsetting morale. Conversely, most workers do not scour the want ads every day for a job that might pay more, because switching jobs exacts a cost in time and effort.

What does this have to do with minimum wages? Plenty. Perhaps the most persuasive-seeming argument against an increase is that many people who earn the minimum are not actually poor: They are teenagers from middle-class homes.

The flaw in this argument is that hiking the minimum wage has a surprising side effect across the bottom half of the wage scale. Even if teens are the largest group getting the minimum wage, low-wage adult workers benefit when the wage is increased, because firms feel a responsibility to increase pay for workers further up the scale.

This result is inconsistent with classical theory, according to which firms would never raise salaries unless forced to. But it is documented by the newer school of behavioral economics. According to a 1986 paper by eventual Nobel Prize winner Daniel Kahneman, co-authored with Jack Knetsch and Richard Thaler, workers care about more than merely maximizing wealth. Notions of fairness keep them from working at too low a wage, even though they will obviously be poorer if they don’t work at all. Economists call this individual minimum the “reservation wage.” (The reservation wage differs across job categories; a bricklayer will accept a lower wage than a doctor.)

Kahneman, Knetsch, and Thaler showed that people’s notion of fairness is influenced by a “neutral reference point.” For most employees, the usual reference points are the wages of other workers at the same firm. Think about it: If wages in the outside world rose faster than yours, you probably would stay on the job, at least for a while. But if you were the only person at your firm passed up for a raise, you’d likely look elsewhere.

Not coincidentally, when the government mandates a hike for a firm’s lowest-paid workers, employers (governed by that invisible handshake) feel pressure to boost other workers’ wages as well. According to more recent research by another trio of economists, Armin Falk, Ernst Fehr, and Christian Zehnder, after a hike in the minimum, “a substantial share” of higher-paid workers also demand raises. “The minimum wage leads to a kind of ratchet effect in workers’ perception of what constitutes a fair wage,” the authors wrote. In a converse illustration, after a hike in the minimum wage, low-paid workers who do not get a raise tend to work less hard. They suddenly feel underpaid.

A frequent argument against the minimum wage is that the earned income tax credit, which provides tax refunds to low-wage workers, is a better vehicle. But neither policy is wholly adequate. Short of a radical increase, the EITC should be a complement to the minimum wage—not a substitute.

What about the claim that a higher minimum will cost jobs? Alan Krueger and David Card chilled that theory in a now-famous 1994 study, “Minimum Wages and Employment,” which found that New Jersey actually gained restaurant jobs after hiking the state’s minimum relative to neighboring Pennsylvania, which did not raise its minimum. This experiment has been replicated, with similar results in subsequent studies.

The fact that job losses do not occur is less surprising when you look away from the textbook and think about the real world. The typical business owner does not use a spreadsheet to calculate whether the incremental output of a new employee will be worth $7.25 an hour (or $8, or $9). Rather, they hire staff when they think it will enable them to serve more customers. A business that is humming will not sack a worker just because the minimum wage is lifted by a buck.

There’s an important caveat: This detour from strict supply and demand can work only for moderate increases. At some wage (pick a number: $15 an hour, $20), the arithmetic becomes overwhelming. A few cities, such as Seattle, recently have imposed Sanders-level wage hikes; early returns suggest that Seattle has indeed suffered restaurant job losses.

Therefore, most economists favor a moderate increase—which is also favored by common sense. “There are positive effects on morale, positive effects on retention—more people want to work,” says Krueger, who was President Obama’s economic adviser from 2011 to 2013. In effect, a minimum wage nudges employers to adopt a pay scale where they, also, are better off. “It’s not what [classical] economics tells us,” Krueger says. “But companies care about their social hierarchies.”

*Source:* [*http://fortune.com/2016/02/29/why-the-next-president-should-raise-the-minimum-wage/*](http://fortune.com/2016/02/29/why-the-next-president-should-raise-the-minimum-wage/)

*1. How do Democrats and Republicans differ on the question of raising the federal minimum wage? What changes are proposed by the candidates in the 2016 Presidential Race?*

*2. What discourages employers from adjusting wages in a similar manner as they would prices during a recession?*

*3. What is the “reservation wage?”*

*4. What does former presidential advisor Alan Krueger argue are benefits of raising minimum wage?*

**Raising minimum wage doesn't work**

By Jake Novak, CNBC, April 21, 2015

The debate over minimum wage has become a super-local issue during the last few years. That's because politicians in several large cities have decided to push for local minimum wage increases instead of waiting for a federal hike. The center of that battle is in Seattle, where a phased-in process leading to a $15 minimum wage began April 1.

The loudest opponents of the new law come from the restaurant and franchise restaurant industry. They've argued for months that the increased minimum wage will force them to increase prices, fire employees or cut employee hours, and even go out of business. But advocates for the wage hikes scoff at those claims and the next year is likely to be filled with lots of dueling statistics, dueling anecdotal stories, and generally a lot of yelling and screaming with neither side backing down.

Whichever side you fall on, there is one undeniable casualty as a result of the minimum-wage hike in Seattle: tips.

The city's new rules say that employers can count tips against the minimum-wage requirement. On top of that, a tipped employee's minimum wage in Seattle is set at $10/hour, compared to $11 for everyone else. While this helps employers meet the new costs, it's likely to turn out to be a triple whammy for the waiters and waitresses who rely on tips:

More taxable income. The current federal minimum wage for tipped workers is just $2.13/hour. In Seattle, the minimum wage for tipped workers even before this "increase" was much more than that, but it was still less than $10/hour. Either way, that first $10 in tips for workers will now become part of a more reportable and taxable income when it used to be a cash-in-pocket payment.

Lower tips. The dining public in Seattle is well aware of the minimum-wage hikes and is seeing this as a "raise" in tipped workers' pay as opposed to a de facto reduction in their income. Many restaurant workers are already reporting reductions in tips as customers take all of this into account.

Math. Employers now have a massive new burden of calculating volatile tip income for each worker and keeping very accurate records and making those gap payments when workers don't reach the $10/hour threshold.

Simply put, this makes it harder for even honest employers to pay their tipped workers accurately and in a timely fashion. And anyone who knows how the real world works knows that when you make it harder to do something, it often doesn't get done. This is not just a hypothetical scenario. All of the major labor activist groups across the country have long argued that tipped workers are more likely to be illegally underpaid. When business is down, they argue, there's a huge incentive for employers not to make up the wage difference for their employees. There are hundreds of documented cases of businesses doing just that.

Meanwhile, that failed "we're from the government and we're here to help" reality in Seattle is now in danger of spreading to the much larger city of Los Angeles. L.A.'s restaurant owners are pushing hard for a similar tipped-income offset to the newly proposed $13.25 to $15.25 minimum wage the L.A. city council is currently considering. And the restaurant owners may win this fight because L.A. Mayor Eric Garcetti is already on record supporting a California state assembly bill that would count tips toward meeting minimum pay requirements. In other words, the push to supposedly raise minimum pay in Los Angeles has a great chance of bringing down a long-standing California law that made working as a tipped employee much more lucrative.

And it's really a bad thing to mess with tipping, because tipping is one of the few remaining ways the customer and the actual person providing a service can relate to one another in a truly free market sense. It's empowering for everyone involved in the transaction. I may not have any control over what my waiter's minimum pay from his employer is, but tipping gives me the power to be the primary source of my waiter's income during the time he's serving me and my family.

The waiter may not be able to improve his base salary more than once or twice a year no matter how well he works. But every time he serves a customer he has an excellent chance of being rewarded more financially for making an extra effort. It's an unwritten contract between the two of us that more often than not results in me getting very good service and the waiter getting a financial boost for doing so. It's a terrible thing to reduce the financial effectiveness of tips because of rules imposed by an outside party who is not the customer, the service provider, or even that service provider's employer. In this case, that outside party is the government.

Maybe we should make our elected leaders work only for tips from the real voters.

1. Which industry has been among the most outspoken against a minimum wage hike?

2. In Seattle, what has the net effect of the minimum wage increase been for waitstaff?

3. How has the new increase made running a business more difficult for employers?

4. What is the minimum wage increase issue of Los Angeles in dispute?

5. What are your feelings about raising minimum wage? Did these articles influence your opinion?