

Money For the Rest of Us, episode 189

Welcome to Money For the Rest of Us. This is a personal finance show on money, how it works, how to invest it and how to live without worrying about it. I'm your host, David Stein, and today is episode 189, titled "Should the minimum wage be raised?"

During the 1936 presidential election, President Franklin D. Roosevelt was in Bedford, Massachusetts. A young girl tried to pass him an envelope, but a policeman held her back. Roosevelt told an aide, "Get the note from the girl." Here's what it read: "I wish you could do something to help us girls. We've been working in a sewing factory and up to a few months ago we were getting our minimum pay of \$11/week. Today, the 200 of us girls have been cut down to \$4, and \$5, and \$6 a week."

A reporter asked the president about that, and Roosevelt said "Something has to be done about the elimination of child labor, and long hours, and starvation wages."

Six dollars a week in 1936 is equivalent to \$108/week today. Only about \$2,70/hour. Roosevelt fought to get that wage increased, to set a minimum wage. The act, that got debated for several years, was The Fair Labor Standards Act of 1938.

There was a piece written by Jonathan Grossman about that; it was on the Bureau of Labor Statistics website, I'll link to it. There was a great deal of controversy regarding raising the minimum wage.

One of the proponents was the commissioner of Labor Statistics, Isador Lubin - he explained to the Joint Senate and House Committee that "the economy had deteriorated to the chaotic stage where employers, with high standards, were forced by cut-throat competition to exploit labor in order to survive."

The outstanding feature of the proposed legislation - he said "Its aim is to establish by law a plain of competition far above that which could be maintained in the absence of government edict." In other words, level the playing field. The wages were so low, the competition so fierce to exploit labor by setting a minimum wage, that would even the playing field. Employers could pay a more fair wage and not feel like they were going to be undercut by their competition.

The opposition used a lot of the same arguments that are used in raising the minimum wage today. Here's how Grossman described, and including quotes by the opposition. He wrote:

"Opponents of the bill charged that, although the President might damn them as 'economic royalists and sweaters of labor,' the Black-Connery bill was 'a bad bill badly drawn' which would lead the country to a 'tyrannical industrial dictatorship.' They said New Deal rhetoric, like 'the smoke screen of the cuttlefish,' diverted attention from what amounted to socialist planning. Prosperity, they insisted, depended on the 'genius' of American business, but how could business 'find any time left to provide jobs if we are to persist in loading upon it these everlastingly multiplying governmental mandates and delivering it to the mercies of multiplying and hampering Federal bureaucracy?'"

One senator, the Indiana Congressman declaimed "canning factories working ... women 10 hours a day for \$4.50 a week. Can the canning factories of Indiana and Connecticut of New York continue to exist and meet such competitive labor costs?" A Southern Congressman, in turn, challenged the Northern "monopolists" who hypocritically "loll on their tongues" words like "slave labor" and "sweatshops" and support bills which sentence Southern industry to death. Some Southern

employers told the Department of Labor that they could not live with a 25-cent-an-hour minimum wage."

That's what ultimately was passed - the minimum wage was set at 25 cents an hour. The night before the signing, Roosevelt in one of his fireside chats warned "Do not let any calamity-howling executive with an income of \$1,000 a day, ...tell you...that a wage of \$11 a week is going to have a disastrous effect on all American industry."

25 cents an hour - that's equivalent to \$4,30 today. That's what it was from 1938 to 1945. At that point, the minimum wage was raised to 40 cents, equivalent to about \$5,51 today. Now we're at \$7,25, the minimum wage in the U.S. It's been that way since 2009.

Thirty states have minimum wage levels above \$7,25. For example, California's minimum wage is \$11. It moves to \$15 in 2022. Washington DC has a \$12,50 minimum wage, moving to \$15 in July 2020. In New York, the minimum wage is \$10,50, moving to \$15 by the end of the year 2020.

One of my questions was how many people actually work for the minimum wage? The Bureau of Labor Statistics reports that 80 million workers, ages 16 and older, are paid an hourly rate - that's about 59% of all wage and salary workers. So 59% have an hourly wage, and of those, 701,000 earn exactly the prevailing federal minimum wage of \$7,25/hour. 1,5 million had wages below the federal minimum wage; so together, 2,2 million workers earn the minimum wage or less, and that's about 2,7% of all hourly paid workers, and about 1,6% of all workers... So not as many as I thought, and it's declining.

So it's 2,7% today, minimum wage and below. Back in 1979 it was 13,4%. So more and more workers are making more than the minimum wage. About 6% of part-time workers make the minimum wage, and about 2% of full-time workers.

Now, minimum wage workers tend to be young. Workers under the age of 25 represent about one-fifth of hourly paid workers, but they make up half of those workers making minimum wage. And teenagers aged 16 to 19 that are paid by the hour, 10% earn a minimum wage or less, compared to about 2% of workers 25 years and older.

Most of the minimum wage workers are in the leisure and hospitality industry. Three-fifths of all workers paid at or below the minimum wage work in hospitality, mostly in restaurants and other food services, and a lot of those workers obviously get tips to supplement their wages.

The question is, if the minimum wage federally is increased to, say, \$15, like it's going to be, or it's working its way toward in California, what's the impact in terms of employment, both in the short-term and in the long-term? Will it lead to greater unemployment among those that were making minimum wage?

There's all kinds of studies out there. I've found three that seem to be the most recent, and the most comprehensive. The first was titled "Wage Shocks and the Technological Substitution of Low-Wage Jobs." It was by Daniel Aaronson and Brian J. Phelan. It came out in December 15th, 2016. They've found that the short-run impact of a minimum wage hike on overall employment was indistinguishable from zero. It didn't have an impact. But it did have an impact on those that were working in what are classified as routine cognitive share jobs. So not routine manual jobs, but routine cognitive jobs, which are a lot of office jobs - secretaries, bookkeepers, filing clerks, or bank tellers.

So the more cognitive, routine-oriented a job was, the greater the impact that they lost jobs, mainly because they were substituted by some type of automation... So those were the jobs that were lost. It wasn't so much the manual jobs, the routine manual jobs, but it was ones with some types of cognition. That's just one study.

They also found that it wasn't due to offshoring. This loss of cognitively routine jobs due to minimum wage increases - that's what it was from, the increase in the minimum wage, not offshoring.

In some, they write, the empirical results are consistent with high labor costs expediting technological substitution in low-wage occupations that are intensive and routine cognitive tasks. Technological substitution... There was greater motivation to use technology when the minimum wage was increased.

Another study was called "Industry dynamics and the minimum wage: a putty-clay approach" by Daniel Aaronson, Eric French, Isaac Sorkin and Ted To. They write "Our results suggest that exit and entry, particularly among limited-service chains (fast food restaurants), increases in the year following a minimum wage hike."

So fast food chains - there was more businesses that left and more that came in, and they didn't find that in full-service restaurants. But their model showed that over time, the low wage restaurants that couldn't compete were substituted with restaurants that were more capital-intensive.

A couple other things they learned from their study is their model determined that the cost of higher minimum wages are fully passed on to consumers in the form of higher prices, and despite these pass-through profits in the firm -- so they would pass on the costs, but the profits actually fell for these restaurants, which is why a lot of them went out of business.

And third, they found that over time, the minimum wage hike - the impact grew over time. In the short-term, some of these studies show there wasn't really a big impact on overall employment, but over time, "labor-intensive incumbent restaurants are slowly replaced with more capital-intensive entrants", restaurants with more automation. We see that today - you go to McDonald's (well, it's fast food), there are kiosks, panels that you can order your food.

Amazon Go opened a convenience store just this week - no workers at all in terms of helping people check out. You don't even have to check out; you just go in and they track you. Now, there's workers in the back, making some of the freshly-made dishes, but automation is occurring. Low-skill jobs have been being replaced by automation for decades, and when the minimum wage increases, that actually spurs that on even more.

One other study is titled "People vs. machine: the impact of minimum wages on automatable jobs." It's by Grace Lordan and David Neumark. They write:

"Overall, we find that increasing the minimum wage decreases significantly the share of automatable employment held by low-skilled workers. Our estimates suggest that an increase of the minimum wage by one dollar (based on 2015 dollars) decreases the share of low-skilled automatable jobs by 0,43%."

They've found it actually had an impact in manufacturing. A dollar increase in the minimum wage in automatable manufacturing jobs decreased employment by 0,99%. So you increase it by a dollar, you

drop employment by 1%. And the sad thing is the share of older workers in automatable employment declined the most sharply. It had the biggest impact on those that were older, women, and black. When the minimum wage was increased, jobs that could be automatable through technology - they were lost.

I'll admit, I've never worked a minimum wage job. Throughout high school I had my own businesses, I did yard work, I was a painter, for a time I worked as a janitor, I could set my own hours... I made \$200/month as a janitor, about \$4.65/hour. At the time, the minimum wage was \$3.35/hour.

After high school though, I wanted a full-time job, so I went to downtown Cincinnati, and there was a hotel - the Netherland Plaza Hotel - they'd spent millions restoring it; it was an art deco masterpiece... And I waited in line, and I got hired as a steward. I didn't even know what a steward was. Stewards wash dishes, they mop floors, they sort garbage, they wash pots. I made \$5.25/hour, 50% more than minimum wage. It equates to about \$12.85 in today's dollars... So I netted \$162/week (about \$395 a week in today's dollars). For the entire year, I made about \$8,400, which would be the same as making \$20,500 today.

If you make \$20,500 today in terms of household income, that puts you in the 18% percentile. So 18% of U.S. households would make less than that, 82% would make more.

It was fascinating working at this place, because I'd never really worked with others, I sort of always worked on my own... Yet, here we were... We were the working poor. Most of my co-workers were African-Americans, and they were certainly older than me, many of them in their 20's and 30's, and this was their life, this is what they made. I was living at home, but I did save a ledger; I tracked my expenses.

This is the month of November 1983 - I took home \$673.36. I saved \$390 and spent \$284. Now, keep in mind, I'm living at home. I spent \$77 in charitable donations. I contributed \$69 to my family to help with utilities and other things. \$44 on dates and entertainment. I only spent \$36 on food supplies and personal items. \$30 on gas. \$1.16/gallon. I drove a 1977 Dodge Aspen... Rusty, very very rusty car. I got 15 miles/gallon, so I drove roughly 375 miles a month. I spent \$28/month on clothes, so the total I spent was \$284/month.

If I had been like my co-workers and had to spend money on apartment, of that \$390 I saved, \$260 would have gone to an apartment. And that was my mom's car -- I would have gone out and bought a 1977 Dodge Aspen. It would have cost me \$2,000.

Interest rate on used car loans were 15%. So that monthly car payment would have been \$52/month. So between the apartment and the car, this is another \$310. With my other expenses, that would have left me only \$80. I haven't even talked about saving for retirement, and my food costs would have been much higher than the roughly \$36 I spent.

As I went over that, I thought about that a lot, because I was making 50% more than the minimum wage. Walmart just announced that their starting pay is gonna be \$11/hour. I was making the equivalent of \$12.85/hour. And we've talked about wage inequality, but raising the minimum wage isn't the solution, because by raising it, that leads to more automation and more unemployment, particularly to those older workers and those that are more vulnerable.

This past week, Larry Fink - the chief executive of BlackRock, the world's largest asset manager. They own the iShares brand, so they're very big in the indexing exchange-traded funds space... He sent a letter to CEOs of companies that they own, saying that it's not enough to deliver excellent financial performance. Here's what he writes:

"To prosper over time, every company must not only deliver financial performance, but also show how it makes a positive contribution to society. Companies must benefit all their stakeholders, including shareholders, employees, customers, and the communities in which they operate.

Since the financial crisis, those with capital have reaped enormous benefits. At the same time, many individuals across the world are facing a combination of low rates, low wage growth, and inadequate retirement systems. Many don't have the financial capacity, the resources or the tools to save effectively. Those who are invested are too often over-allocated to cash.

For millions, the prospect of a secure retirement is slipping and further and further away, especially among workers with less education, whose job security is increasingly tenuous. I believe these trends are a major source of the anxiety and polarization that we see across the world today."

That's where I was - I was uneducated; I had a high school degree. I was the working poor. I couldn't have made it. And that's the same boat a lot of workers are in today, and Fink's asking companies to consider this, to think about that. He says companies must ask themselves, "What role do we play in the community? How are we managing our impact on the environment? Are we working to create a diverse workforce? Are we adapting to technological change? Are we providing the retraining and opportunities that our employees and our business will need to adjust to an increasingly automated world?"

These are major forces. This automation is real. Competition is tough, but businesses have to think about are they treating their workers fairly? It's not enough just to maximize profits and buy back stocks.

Now, we have to do the same thing. If you're a business owner, you have to ask, when you hire people, is it fair? How are they going to live on that wage, based on what we're paying - just like I did a budget, and you could see; I made this back in 1983 - how is somebody supposed to live on that wage, and is it fair?

When we pay for services for our house - housekeeping, lawn care, home repairs - do we just choose based on who has the lowest price? Do we consider "Well, if they clean my house for this price, how many houses can they clean a week, and can they live on that?" That's what my mom did while I was in high school, she cleaned houses, and it was tough to get by, which is why I had to contribute a part of my salary at \$5,25/hour.

So I don't think raising the minimum wage is the answer, because it just spurs more automation. It has to come from the bottom up, with businesses and individuals. We have to think about how much do we tip. Are we tipping enough? Are we paying enough for the services that we're getting? And especially if you own a business, are you paying the workers a fair wage?

It's hard. I admit, we ran a business for many years, and it was hard to figure out "What do you pay people?" It's not always easy to get that answer, but at the bottom you have to figure out "Is it at least fair? Is it enough money to live on?"

After spending a year as a dishwasher, I realized "This isn't gonna work." I eventually went to college, because that's ultimately how you get to the point where you can make more, and are not going to necessarily be replaced by technology. It's the jobs that are non-routine that require cognition, the creative jobs; the jobs that require not a task that can be automated, but a task that can't be, that requires empathy. As individuals, that's what we need to do, is to find jobs like that, and increase our education. But then as businesses, we have to be fair and make sure we're paying our workers fairly.

Have a great week!