

Raising the Minimum Wage

Misguided Policy, Unintended Consequences

by Robert P. Murphy, Charles Lammam, and Hugh MacIntyre

Proposals to increase the minimum wage have re-emerged in provinces across the country. For instance, the Alberta government recently pledged to hike the provincial minimum wage from \$10.20 to \$15 per hour by 2018, already taking the first step with a \$1 hike effective October 1, 2015. There has been a similar movement to raise the minimum wage to \$15 in various jurisdictions in the United States.

Popular support for the minimum wage largely derives from the belief that it is a useful tool for boosting the wages of poor workers. However, the evidence paints a much different picture. For starters, the minimum wage does not effectively target workers in low-income households. In fact, 87.5% of Canadians earning minimum wage in 2012 lived in households above the Low Income Cut-Off (LICO), a widely used measure of relative poverty. Moreover, the vast majority of workers (83.4%) from households falling below the LICO threshold earned more than the minimum wage.

These counterintuitive results follow from the demographic composition of minimum wage earners. In 2014, 58.4% of those earning minimum wage were youths aged 15 to 24. Furthermore, 56.8% of all minimum wage earners were living with family, while 19.9% were married to a spouse who was also employed. Taken together, the data undercut the popular image of minimum wage earners being single breadwinners supporting a family. In fact, only 2.2% of those earning minimum wage were unmarried heads of household with at least one minor child.

The tenuous link between minimum wage earners and poor households makes the minimum wage a very crude method for targeting assistance to those who need it. At the same time, hiking the minimum wage can do considerable harm, most notably by decreasing employment opportunities among low-skilled workers—the very group the policy is designed to help. By making labour artificially more expensive, increasing the minimum wage may significantly reduce employment among teenagers and other groups of low-skilled workers. Besides reducing employment outright, hiking the minimum wage could lead to a reduction in hours and other benefits (such as on-the-job training) for those workers who keep their jobs.

There is an enormous body of empirical research examining the effects of the minimum wage. Canadian studies are considered of higher quality than US studies because (among other reasons) there is a wider variability in the provincial Canadian minimum-wage variable. The Canadian literature generally finds that a 10% increase in the minimum wage reduces employment among teens and young adults (ages 15 to 24) by 3% to 6%. By making it harder for low-skilled

workers to obtain an entry-level position, the minimum wage may perversely hinder the development of human capital and harm the long-term career prospects of the very people it ostensibly helps. Indeed, Canadian researchers have found that hiking the minimum wage has no statistically significant impact on poverty and in some cases can increase it.

Up through the 1980s, research in the United States reached similar conclusions, though the impact of the minimum wage on youth employment was not as severe as reported in the Canadian studies. It is true that a wave of “new minimum wage research” emerged in the United States in the 1990s, challenging the original consensus. However, there have been dozens of US studies since then that endorse the original findings, some of which employ techniques similar to those of the revisionist studies. Furthermore, some leading researchers in the field actively dispute the validity of the “new” approaches.

Fortunately, rather than the dubious policy of increasing the minimum wage, there is a better option for helping workers from poor households, namely increasing the Working Income

Tax Benefit (WITB). This Canadian program is a refundable tax credit that allows qualifying low-wage workers to keep more of their earnings, effectively subsidizing them to work more. Unlike traditional welfare programs, the WITB is specifically designed to minimize the disincentives that can occur when government assistance is removed at higher income levels. Because it targets the desired individuals more accurately and avoids price controls, the WITB is a much more sensible (although not flawless) approach to channeling resources to the aid of workers from low-income households.



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Family composition of employees earning minimum wage in Canada, 2014

11.0%—single (living alone or with non-family room-mates)

26.3%—living with spouse (with or without children)

3.5%—single head of household, with no minor children

2.2%—single head of household, with at least one minor child

56.9%—son, daughter, or other relative living with family

