

**Terre Haute Tribune-Star Progress Monthly
November 2006**

“Should We Do More Than The Minimum?”

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In the run up to the November elections, leaders of the Democratic Party promised that if they regained control of Congress they would pass legislation raising the minimum wage. In fact, one proposal already introduced in the Senate before the election would raise the minimum wage from its present level of \$5.15 to \$6.55 within 12 months and to \$7.25 within 24 months. That would be a 40% increase.

The main argument for raising the minimum wage is that inflation has eroded its purchasing power since it was last raised to \$5.15 in 1998. The main argument for not raising the minimum wage is that raising it runs the risk of pricing some people out of a job as their wages rise to a level that companies no longer are willing to pay.

We’ve had a minimum wage in this country since 1938. As the accompanying chart shows, for about 15 years between the mid 1950s and 1968 the minimum wage increased dramatically in inflation-adjusted terms. By 1968 the purchasing power equivalent of the \$1.58 minimum wage was about \$9 in today’s terms.

After 1968 this trend reversed. By 1988, infrequent increases coupled with inflation had eroded the purchasing power of the minimum wage to below \$6 in today’s dollars. Since then, the purchasing power equivalent of the minimum wage has remained fairly close to that level, although it has obviously fallen over the nine years since the last increase.

One interpretation of the inflation-adjusted line is that as a society we were very generous between the mid 1950s and the late 1960s, became stingier between 1968 and 1988, and have maintained a fairly constant level of purchasing power since then. Such an interpretation raises a lot of interesting questions, not the least of which is what happened in the late 60s to cause us to alter course.

Another reasonable question, however, might be whether an increase to \$7.25, such as that being considered, is a good idea at this time. Naturally, there are plenty of opinions on the topic. I’ll focus here on two important considerations – the magnitude of the proposed change in real, or

inflation-adjusted terms, and the timing of the change.

Assuming that present rates of inflation continue for the next couple of years, a 40% increase in the minimum wage will substantially outpace inflation and represent a significant increase in purchasing power. The upward spike at the end of the chart projects the effect of an increase to \$7.25. Perhaps after nine years of eroding purchasing power such an increase is overdue, but as the chart shows, by historical standards such an increase would be very abrupt.

The timing of such an abrupt change might be critical. There are probably good times to raise the minimum wage and bad times to raise the minimum wage, and which ones are which might come as a surprise to many people. The good times would be when the economy is strong and wages for low-skill labor are above the minimum wage. The late 1990s, when fast food restaurants were offering \$7 an hour, was such a time. In such an environment, any job-reducing effects of a rising minimum wage would be muted. Conversely, the bad times would be when the economy is weakening or moving into recession. It is precisely at such times that a rising minimum wage is more likely to have an adverse effect on employment. After all, if you think you are coming down with a cold, then it’s not a good idea to stand out in the rain.

So if our notions of fairness lead us to conclude that it’s time to adjust the purchasing power of the minimum wage, let’s take the economy’s temperature first and proceed carefully. If we think the economy is slowing down – and the latest GDP figures from the government seem to indicate that it is – it’s probably not a good time to do something dramatic. If we are really concerned about the welfare of those who earn the minimum wage, right now may not be a good time to push through a dramatic increase. Instead, politicians may be well-advised to carefully nudge it up just a bit until we see evidence that the economy is picking up steam.

