

Is a Higher Minimum Wage Going to Help You?

By: Joe the Investor

There are many issues embedded in the concept of a higher minimum wage. Why? The economy does not live in a vacuum – if you change one variable (wages), the other variables will adjust until there is a new balance. The typical reaction is that a higher minimum wage means that if I am earning it, I will have more money to spend *on the same items at the same price and therefore I will be better off*. The words in italics are assumptions that are assumed to stay the same.

If you pay workers more money to produce the same goods, the price of these goods will be higher assuming the company wants to preserve its profits. Will this always happen? If you have existing heavy competition, companies have low profit margins and if they cannot recoup the higher wage costs, would likely lose money and then go bankrupt. Some of the employers may adapt by cutting costs in other areas, like hiring fewer workers and investing more money in machines or computer software. Other companies may charge more for shipping or specific products but cannot do this for everything they produce. The effects of a company making these adjustments will mean higher unemployment or more hours for the remaining workers. More hours may be paid at less than the higher wage in a bid to reduce wage costs overall. If you have an industry that does not have heavy competition, this is an industry that is monopolistic or concentrated among a few producers. This typically means that they can pass on higher costs to you the consumer and nullify any benefit of higher wages.

The effect on the consumption side will also not be static. If more people are earning higher wages, they will have more money to spend on whatever they purchase. If the products available are the same, people will have a tendency to pay more for the same products because the demand will be higher. This is like having a bidding war at an auction sale, but in the case of higher wages for many people, the bids will be higher due to more money available money to bid on the products. This translates into higher prices coming from the demand side of a transaction.

Does this mean that wages should never rise and people should never earn more money? The answer to this question is no, but there are a series of “it depends” factors that would affect the scenario which should respect the laws of economics. If someone is getting paid higher wages, the implication is that they are producing more goods and services or something of more value is being created which would justify the higher wages. The higher wages would come from the free market of supply and demand instead of legislation or forced outcomes. Why? The free market will determine where the value is in raising wages and for what jobs and in what sectors.

An example of this argument is investing in technology so that there would be more efficiency and higher paying jobs for people who manage the technology. The assumption is that the technology will produce more efficiently, thus creating value. The downside is that the technology will displace more workers who are replaced by the technology, thereby creating higher unemployment. This surplus unemployment will create a glut of workers overall, and lower wages for the people who are not in the “in demand” technology sector. Is this better or worse overall? It is not known as there are many variables to examine.

The takeaway from this article is that there are no free lunches in finance or economics. If there are higher wages, there will be a cost somewhere for this. Will the cost come back to bite you as a worker, a consumer, or an employer? There are always winners and losers when things shift in the economy and there typically has to be a new balance that has to be achieved in order for the economy to function in

the long term. The value produced in an economy is turning time into money via hard work, turning raw nature into something that people can use, or using inventions or technology to create more value out of an existing process. If one of these things is not happening or not improving, be suspicious of any movement to raise wages, raise prices or offer anything for free.