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MINIMUM WAGES

Minimum wage legislation is a legacy of the 1930's, when government was small and fiscal devices to sustain income and employment were not respectable. One diagnosis of the depth and length of the Great Depression that was current in the 1930's is that the substantial fall in money wages that occurred in 1930-33 made things worse. This diagnosis is true for in a world with borrowing and lending the validation of debts that are incurred at a "high" price level becomes an impossible task if there is a substantial fall in prices.

The large fall in money wages and prices that occurred between 1929 and 1933 meant that the cash flows necessary to validate the debts of the 1920's would be much more difficult if not impossible to generate. In the 1930's it was felt that for the Depression to end it would be necessary to raise the wage and price level at least part way back to the levels of the 1920's. Minimum wage legislation was designed to raise current wages and to prevent any future recession from leading to as sharp a fall in prices and wages as had occurred. The price level in 1933 was some 25% lower than in 1929. To a contemporary observer and politician this was one of the causes of the depth and duration of the depression. This view of politicians and observers flew in the face of the opinions derived from the then dominant theory, which held that the price level was neutral.

It is worth noting that in its origins minimum wage legislation was overtly inflationary. This was presumably good in an era where deflation and the consequences thereof was the major problem. The

continuation of a legislated minimum in an age where chronic inflation is a major recognized problem is a paradox. The inflationary bias in minimum wages is especially marked when policy attempts to set minimum wages at a high ratio to about half of the average wage in manufacturing. Minimum wages would do no harm if the minimum were a small percentage of the average wage but any legislative indexing of minimum wages at a high ratio to the average wage triggers chronic inflationary pressures.

Incidentally, just as the minimum wage legislation is best viewed as an attempt to prevent wages from falling in a depression, so the maximum hours legislation - the institutionalization of the 40 hour week that took place in the 1930's - is best viewed as an attempt to spread available work. Both minimum wage and maximum hour legislation are acts of resignation, which reflect an acceptance of the view that periodic downward pressures on wages through unemployment is inevitable and that, in truth, our economy is not able to generate sufficient jobs for all who want to work. Work must be shared and deflations must be prevented is the philosophy underlying the minimum wage legislation.

The minimum wage was 40 cents per hour throughout World War II. In 1950 the minimum wage was raised from 40¢ to 75¢. In 1949 the average hourly earnings in manufacturing, the index we always use to deflate relative wages, was 3.45 times the minimum wage. The large 1950 rise in minimum wage lowered the ratio of manufacturing wages to the minimum wage to 1.92. The minimum wage remained at 75¢ per hour from 1950 through 1955. During this period, the minimum wage deflated by the C.P.I. (1967 = 100) fell by some 10% from \$1.04 to \$.95 and the ratio of average hourly wages in manufacturing to the minimum wage rose to 2.48 in 1955 from the 1.92 of 1950.

The minimum wage was raised to \$1.00 in 1956 and remained at that level through 1961. With the increase to \$1.00, the deflated minimum wage rose by 30% from the 1955 level to \$1.23. However, because of the rise in the consumers price index between 1956 and 1961, the minimum wage deflated by the C.P.I. fell about 10% to \$1.12 in 1961. The ratio of the average hourly wage in manufacturing to the minimum wage fell to \$1.95 in 1956 and rose to \$2.32 in 1961. In terms of the ratios of manufacturing wages to the minimum wage the experience of 1956-61 paralleled that of 1950-1955.

After 1961 the relative stability of the minimum wage was abandoned: in 1962 the minimum wage was raised to \$1.15, in 1964 to \$1.25, in 1967 to \$1.40 and in 1968 to \$1.60. Between 1968 and 1972 the minimum wage remained at \$1.60. In 1973 it was raised to \$2.00, in 1974 it was raised to \$2.20, and in 1975 it became \$2.30. As the minimum wage went from \$1.60 in 1968 to \$2.30 in 1975 the minimum wage deflated by the C.P.I. fell from \$1.54 to \$1.42. The purchasing power of the minimum wage grew at a compound rate of 1.25% throughout the 25 year span 1950-1975; however, this is broken down into a growth rate of 1.59% during 1950-1965 and a growth rate of 0.73% in 1965-1975. In fact, the purchasing power of the minimum wage peaked at \$1.54 in 1968 and has declined to \$1.42 in 1975.

With the beginning of the more frequent increases in minimum wage in 1973, the ratio of the average wage to the minimum has been held in the neighborhood of 2.0. However, over the five year period 1968-1972, when the minimum wage was unchanged at \$1.60, the ratio of the average wage in manufacturing to the minimum wage rose from \$1.88 to \$2.38. The

experience of the 1950-1955 and 1956-1961 periods was repeated in 1968-1973. The evidence indicates that if a minimum wage is established and sustained for a time, its deflated value and its ratio to market wages will fall. This evidence can be interpreted as indicating that an attempt by legislation to establish and sustain a minimum wage that is in the neighborhood of half of the average wage in manufacturing sets up a disequilibrium. The economic mechanism that we have attempted to resolve this disequilibrium by "inflating away" the increase in the dollar minimum wage. Inflating prices and average wages in manufacturing are reactions of a market economy to untoward high minimum wages.

In the light of our argument that the money wage rate is a determinant of the course of inflation, the course of the minimum wage and of the ratio of manufacturing wage (as well as other wages that enter into the price of products) to the minimum wage are important determinants of the price level.

The rate of growth of average hourly wages deflated by the consumers price index was 1.60% for the entire period, 2.14% between 1950-1965 and 0.77% between 1965-1975. Over the same periods the deflated minimum wage grew by 1.25% over the entire period, by 1.59% between 1950-1965 and 0.73% between 1965-1975. It is quite clear that whatever apparent success may have been enjoyed in achieving deflated wage growth through increases in the average and minimum wages early in the post-war period was not repeated in the 1965-75 decade. Deflated real wages and the deflated average hourly earnings in manufacturing hardly grew at all in the 1965-75 period. Furthermore the ratio of the average wage to the minimum wage was 2.09 in both 1965 and 1975.

Minimum Wages
and
Average Hourly Wages in Manufacturing

Nominal and Deflated
1950-1975

	Minimum Wage		Consumers Price Index ¹	Average Hourly Earnings in Manufacturing		
	Nominal	Deflated by C.P.I.		Nominal	Deflated by Minimum Wage	Deflated by Consumers Price Index
1950	.75	1.04	72.1	1.44	1.92	2.00
1951	.75	.96	77.8	1.56	2.08	2.01
1952	.75	.94	79.5	1.65	2.20	2.07
1953	.75	.94	80.1	1.74	2.32	2.17
1954	.75	.93	80.5	1.78	2.37	2.21
1955	.75	.94	80.2	1.86	2.48	2.32
1956	1.00	1.23	81.4	1.95	1.95	2.40
1957	1.00	1.19	84.3	2.05	2.05	2.43
1958	1.00	1.16	86.6	2.11	2.11	2.44
1959	1.00	1.15	87.3	2.19	2.19	2.51
1960	1.00	1.13	88.7	2.26	2.26	2.55
1961	1.00	1.12	89.6	2.32	2.32	2.59
1962	1.15	1.27	90.6	2.39	2.07	2.64
1963	1.15	1.25	91.7	2.46	2.14	2.68
1964	1.25	1.35	92.9	2.53	2.02	2.72
1965	1.25	1.32	94.5	2.61	2.09	2.76
1966	1.25	1.29	97.2	2.72	2.18	2.80
1967	1.40	1.40	100.0	2.83	2.02	2.83
1968	1.60	1.54	104.2	3.01	1.88	2.89
1969	1.60	1.46	109.8	3.19	1.99	2.91
1970	1.60	1.38	116.3	3.36	2.10	2.89
1971	1.60	1.32	121.3	2.57	2.23	2.94
1972	1.60	1.28	125.3	3.81	2.38	3.04
1973	2.00	1.50	133.1	4.08	2.04	3.07
1974	2.20	1.49	147.7	4.41	2.05	2.99
1975	2.30	1.42	161.2	4.81	2.09	2.98

Growth Rates %*

1950-					
65	3.41	1.59	1.80	3.96	2.14%
1965-					
75	6.10	.73	5.34	6.11	0.77%
1950-					
75	4.48	1.25	3.22	4.82	1.60%
1968-					
75	5.18	1.15	6.23	6.61	0.04%

$$*g = \ln\left(\frac{t_n}{t_0}\right) + n.$$

¹1967=100

In the economy we now live in it seems apparent that almost all of any increase in minimum wages will be inflated out and that the average wage will tend to rise in the same ratio as the increase in the minimum wage. If there is some ratio of the average wage in manufacturing to the minimum wage at which the minimum wage does not impart an inflationary push to wages this ratio is lower than the 2.00 which has been the apparent target of legislation.

In the three periods over the past 25 years in which the minimum wage was temporarily stable, 1950-55, 1956-61, and 1968-71 the initial ratios of the average wage in manufacturing to the minimum wage was 1.92, 1.95 and 1.88 respectively and at the terminal year the ratios were 2.48, 2.32, and 2.38. All and all, our experience with minimum wages has been an exercise in futility: neither the absolute nor the relative positions of the lowest paid employed workers can be improved by this device.

Once we have introduced the powerful **device** of fiscal policy in the context of a big government into our arsenal of policy we have essentially removed the threat of run-away wage and price deflation. The experience of 1974-75 during which prices continued to rise even as unemployment rates reached levels reminiscent of the Great Depression indicates that even the inefficient fiscal devices that predominately depend upon transfer payments prevent wage and price declines during periods of serious slack.

The function of minimum wages in an economy in which the shape of the business cycle has been changed by policy so that strong cumulative debt deflations are not possible is to establish and sustain a minimum standard below which life standards are not allowed to fall. But **if**

there is to be a minimum below which life standards are not to fall, then there must be a job or income guarantee at this standard. The replacement of a legislated minimum wage with a "tap" employment device is a way in which the minimum wage can become a guarantee of income, for the wage standard set by the "tap" employment agency becomes the effective minimum.

The trends in 1950-55, 1956-61 and 1968-72 indicate that a minimum wage at 50% of the average wage in manufacturing is too high for price stability. In 1948 and 49 the last year at which the minimum wage was at the pre-war 40 cents level, prices were stable. At that time the minimum wage was about 1/3 of the average wage in manufacturing. We can assume that a minimum wage equal to 1/3 of the average wage in manufacturing does not impart any serious inflationary thrust. Given the trends in the periods of temporary stability in minimum wage 1950-55, 1956-61, and 1968-72 we can assume that a minimum wage between 1/3 and 2/5 of the average wage in manufacturing will provide a floor to life style at the same time as imparting a minimal inflationary thrust to the economy.

With a moninal average hourly wage in manufacturing, \$4.81 in 1975, a minimum wage at the 40% range would be approximately 1.92, a minimum wage at the 1/3 level would be approximately \$1.60.

The attached table, taken from an article by Michael R. Darby in the Journal of Political Economy shows that the relative wage of the "emergency workers" in W.P.A., C.C.C. and out of school N.Y.A. in the depression was in the 40-50% range when compared to the industry average annual wage. In 1975 the average weekly wage of private non-agricultural workers was \$163.89: a weekly wage on the tap employment

**EMERGENCY GOVERNMENT LABOR FORCE
EMPLOYMENT AND WAGES, 1933-43**

YEAR	FEDERAL EMERGENCY WORKERS (THOUSANDS) (1)	AVERAGE ANNUAL WAGES		RELATIVE WAGE OF EMERGENCY WORKERS (%) (4)
		Emergency Workers (\$) (2)	All Industry (\$) (3)	
1933	471	755.83	1,048	72.1
1934	2,475	508.69	1,091	46.6
1935	2,575	469.51	1,137	41.3
1936	3,653	595.13	1,184	50.3
1937	2,707	605.10	1,258	48.1
1938	3,572	590.71	1,230	48.0
1939	3,216	583.02	1,264	46.1
1940	2,792	565.54	1,300	43.5
1941	2,192	553.38	1,443	38.3
1942	909	638.06	1,709	37.3
1943	85	588.24	1,951	30.2

SOURCES.—Col. 1: Federal work relief full-time and part-time employees, table 6.3, line 78, pp. 98, 99, of U.S. Department of Commerce (1966). For 1934 and 1935, 1,335 thousand and 1,585 thousand, respectively, employees of FERA's state-administered Emergency Work-Relief Program are added on the basis of annual average of monthly data for April 1934-December 1935 in table 13, 3d col., p. 46, of U.S. Work Projects Administration (1942). Slightly different data (taken from preliminary reports such as FERA [1936] but showing monthly breakdowns by program) on the emergency government labor force are available in NICE (1941, 1945). Col. 2: Wages and salaries of federal work relief employees, table 6.2, line 78, pp. 94, 95, of U.S. Department of Commerce (1966) divided by col. 1. For 1934 and 1935, \$495 million and \$598 million, respectively, have been added to wages and salaries as the proportionate share of FERA workers in total state and local work relief wages reported (ibid., line 84) for those years. This is a minimum estimate as work relief recipients in state and local programs in 1933 averaged less than half the average for 1934. Col. 3: Average annual earnings per full-time employee in all industries, Series D696, U.S. Bureau of the Census (1960), p. 95. Col. 4: Col. 2/col. 3.

at 45% of the private non-agricultural rate would be \$73.75. Given the patterns that seem to exist on average hourly wage in the \$1.75 - \$1.80 range for a worker in the various tap projects seems to be consistent with a non-inflationary program. Given the range of programs that would be necessary the hourly wage on tap employment projects might range from \$1.50 per hour for the 16 year old in a modern NYA to a \$2.00 an hour for adult workers on W.P.A.