# The Unseen Tariff of the Federal Minimum Wage

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## The Lesson

Henry Hazlitt declared in his revered book "*Economics in One Lesson*" a lesson that created a clear distinction between good economists and bad economists.

> "The art of economics consists in looking not merely at the immediate but at the longer effects of any act or policy; it consists in tracing the consequences of that policy not merely for one group but for all groups." [1]

From this single lesson Hazlitt, or anyone else, can interpret effects from policies ranging from public projects to war spending to price floors/ceilings. The whole gamut of fallacious economic arguments are covered by Hazlitt, but two I will be covering are outlawed work and outlawed trade, I.e. minimum wage laws and tariffs. There is an unseen and unspoken of tariff within the minimum wage laws that harms otherwise willing workers who become artificially priced out of the market by these laws based on their geographical locations. This is seen ad absurdum with the *federal* minimum wage law. Before I get to this tariff, I must provide context.

### A Free Market for Labor

In a free market for labor, which is not interfered with or maligned, the equilibrium of market employment is where the supply of labor meets the demand for labor. At this point, you find the market clearing wage and the market clearing quantity of employed workers. Also from this, you will find the Consumer and Producer surpluses, which is what each party has gained from their transaction. In the case of the labor market, the consumers are firms looking to hire, and the producers are the people willing to work.

**Minimum Wage Laws**

Minimum wage laws are an example of a price floor, an effective (binding) price floor is one that is set above the equilibrium price. A binding price floor for wages results in a lower demand for workers, a minimum wage higher than markets would dictate, and a greater supply of people willing to work for this newly created minimum (floor) wage. The amount difference between the newly willing workers and the lowered demand of workers is an artificially created surplus of workers.

There is a loss in the consumer surplus created from the policy, which is the amount of prospective workers that would have been hired under the market equilibrium rate, and how much money they would have made for having those workers. There is also a loss in Producer Surplus, which is the amount of jobs offered at the new rate subtracted by the amount offered at an equilibrium price and how much money would have been made from that. In other words, the gains from trade have been cut into. After the minimum wage was put into place, the workers employed now make the price floor wage, which is higher, but this is at the expense of a reduction in quantity of workers.

Now let’s say another state implements the same minimum wage, but in a state with an equilibrium rate closer to the minimum wage. The state with a lower disparity between equilibrium rates and minimum wages will not be harmed as much in regards to job loss. In such an example, there is still a deadweight loss, but the hardship is not nearly as significant. With a constant quantity and elasticity of supply/demand curve, the greater the increase in minimum wages in reference from equilibrium price point, the greater the deadweight loss.

**Tariffs**

Tariffs, and other protectionist policies, come about to counter geographical competition. Tariffs are used to retain local industries, but in reality only harm the use of a dollar, creates a misallocation of funds, and holds back people's time that could have been better served in other ways.

Hazlitt's distinction between good and bad economists comes out to play once again with protectionism. Industries saved or propped up by tariffs are *seen*, but what remains *unseen* is the opportunity cost. Where could that money have otherwise been invested? Where could the workers have worked instead? Would they have instead learned a trade or go back to school? For as long as the tariff is in place, those resources are being allocated inefficiently. Hazlitt's chapter on tariffs and says the following

> "It changes the number of occupations, the kind of occupa-
> tions, and the relative size of one industry as compared with another. It
> makes the industries in which we are comparatively inefficient larger, and
> the industries in which we are comparatively efficient smaller. Its net
> effect, therefore, is to reduce American efficiency, as well as to reduce
> efficiency in the countries with which we would otherwise have traded more
> largely."[2]

Such a distortion from the market clearly has ripple effects. Looking back at the original lesson, some groups will benefit from tariffs. Those in industries being protected, specifically. The costs however are astounding, the United States imported $466.7 billion worth of goods in 2014 from China alone. [3] To echo Hazlitt, free trade allows for those to produces whatever they're most efficient at producing. The trade is mutually beneficial a priori. If trade wasn't, it simply would not happen.

**Interstate Protectionism**

The unseen tariff I have been getting at is the punishment of the federal minimum wage on low income areas during interstate commerce. Tariffs, with protection at intent, or not, only harm everyone involved. The "protected" party suffers from higher costs of goods while the tariffed party is at a loss of sales. Through comparative advantage, interstate trade lowers the prices for consumers allowing them to have a greater quantity of goods than they previously would have had. The quantity supplied within a given state is lower, but it's made up for through imports at a lower cost. With a tariff on imported goods, you reduce the amount of imports in favor of more goods produced within the state. The amount of domestic production *is* raised, but the difference between Quantity demanded pre-tariff and Quantity Demanded with Tariff is consumption entirely lost. There is also a loss of funds from consumers being funneled in by the government. The revenues are both a transfer and misallocated funds, as they would have been put elsewhere if the tariff were not in place. In addition to that, the price of goods raise and the quantity demanded falls.

**Federal Minimum Wage Laws**

Instead of a state or locality targeted minimum wage (I will get to these), federal minimum wages are imposed on the entire country indiscriminately. The difference between equilibrium prices and the newly created floor is especially *seen* when you look at a federally mandated minimum wage.

Let's say there are two states, state A and state B, both of which are at the mercy of the same federal laws. One state, state A, has lower costs of living and citizens are willing to work at a rate of say $1 an hour. On the opposite end, state B has a comparatively higher cost of living and the lowest end of people workers settle for $10 an hour. An application of a federal law would most likely be one at a rate higher than both equilibrium rates for low end employees, one of say $15 an hour. Both states will be at a loss of otherwise willing workers, but the state with the market rate closer to the floor will not suffer nearly as much.

The difference in deadweight loss of the two states is a tariff in that it is a punishment on geographical trade. The low cost area must be dragged up to the same minimum wage, despite their costs of living being lower. Costs of living may not even be deciding factor for someone to live in a low cost area. Implicit costs go into people's decisions of where to live. Someone may live in an area because of their distance to home, the quality of air, the weather. People who have moved to areas with low costs of living for non-monetary benefits are now imposed a cost. Government as an externality, who'd have thought?

Raises in minimum wages only exacerbate the issues they cause. It should be no surprise that recent calls for a $15 minimum wage come from those living in areas with high cost of living, as they're the ones hurt the least from the new changes. Two prominent examples of $15 minimum wage advocates would be Senator Bernie Sanders of Vermont and Robert Reich out of California. A place you won't find calls is Puerto Rico.

**Puerto Rico**

Puerto Rico may be the closest thing to a case study into my thesis, as they're subject to the federal minimum wage laws of the United States. In a report on the state of Puerto Rico's affairs, economist Anne Krueger says only 40% of the adult population is in the labor force while the United States is at 63%.[4] Compared to the United States, Puerto Rico has a much greater percentage of citizens working at the minimum wage rate, nearing a third of all workers (opposed to United States' 16%). Now, why is that? Our federal minimum wage is binding. A closer cost of living to Puerto Rico than the United States is their neighbor, the Dominican Republic.

In US dollars, the 2008 Dominican Republic minimum wage $0.84 an hour, with a living wage of $2.83. [5] Their definition of a living wage is one that "should cover the cost of meeting a family's basic needs in the following categories of goods and services: food and water, housing and energy, clothing, health care, transportation, education and childcare, as well as modest funds for savings and discretionary spending.". Puerto Rico's cost of living should be more aligned with Dominican Republic, they share many contributing economic factors such as climate, industries, and agricultural exports. What separates the two counties are the institution in play. The United States' federal minimum wage halts Puerto Rico from having a labor force participation rate within even

20 percentage points of Dominican Republic's. [6] The seedy underbelly of the benevolent federal minimum wage law has crippled Puerto Rico for the time being. The case of Puerto Rico should show us why the minimum wage, at the very least, should be in the most local hands possible, with the market clearing rate as the most desirable option.

**Problem with wage laws themselves**

A call for a minimum wage law is a call to outlaw work. To say, one should be too dignified to work for a certain wage, therefore the option should not exist. The issue is inherent not with just the federal minimum wage, but ones from the state level as well. California could be a real example. California is the first state set to run with the trendy $15 minimum wage. [7] California, much like the United States as a whole, is a diverse group of land paired in accordance to its location. It features many different suites of life and industry, not just the lavish Hollywood lifestyle. Statewide legislations aren't fit for the agricultural northern Californians, who have gone as far as calling for secession from the state. [8] Two issues related to the call to form the 51st state are "Laws that will hold our representatives accountable to us", us being the northern counties, and for "Utilization of our natural resources - timber, water, farming, mining, hunting and fishing". [9] Both being geographical punishments on people within a state for not having the same costs that with those that have wildly different lifestyles within their own state. No matter how large or small you get with the laws, they will harm those that were supposed to be helped the most.

**The Unseen Tariff of the Federal Minimum Wage**

The federal minimum wage unjustly brings a floor that may not wholly harm one area (areas where the equilibrium is close to the floor), but will devastate another, or in one specific case, Puerto Rico. The tariff of the federal minimum wage comes from cost structures that go into these states. Industries can thrive in some states while not existing in another. Comparative advantage is no new concept, and as I mentioned earlier, mutually agreed upon trade is beneficial, a priori.

The effect of a federal minimum wage is similar to that of a tariff in that they both create a deadweight loss that eats away potential gains from situations of comparative advantage. In both situations, funds are misallocated, lowering the total social surplus. They're both implemented with good intentions, but clearly have their faults. Rounding back to *The Lesson*, we can still learn from Hazlitt new effects from government policy. We don't need to wait to find the fallacies in government policies. We *especially* don't need to go through the hardships others have seen. Ad infinitum, a federal minimum wage drives out labor entirely, something Puerto Rico can nearly grasp.

## Citations


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