YOUTH UNEMPLOYMENT AND MINIMUM WAGE (2012 Annual Averages)		
Age of labor force	**Percent of workers paid hourly rates at or below minimum wage**	**Unemployment rate, %**
16 to 19 years	21.1	24.0
20 to 24 years	8.7	13.3
25 years and over	2.9	6.8
Source: Bureau of Labor Statistics		

The High Cost of a Free Lunch

by Richard W. Rahn

WHEN THE MINIMUM WAGE GOES UP, SO DOES UNEMPLOYMENT

Last week, President Obama said that "income inequality" is the major problem that his administration would focus on for the remainder of his term. He proposed increasing the minimum wage as a way to solve this issue. The president's statement is a perfect example of how politicians misdiagnose problems and then offer solutions that make matters worse.

The real problem is the lack of economic growth, which reduces economic opportunity, particularly for the least skilled. Increasing the minimum wage helps those who actually receive an increase in their wage, but it makes it worse for all of those who lose a job or can't get one because the minimum wage is far above the market clearing rate. As can be seen in the accompanying table, most minimum-wage workers are young people who quickly obtain higher wages as their work skills improve.

Most employers who have many minimum-wage employees have very low markups on their products, whether they are selling fast food or general merchandise. Higher wage costs will cause them to raise prices. Higher prices means they will sell less, and the real purchasing power of their customers will be lower. There is no free lunch.

Employers will also have an incentive to automate more. Through the use of self-service scanners, customers are taking over many of the checkout jobs that employees used to perform. As minimum wages go up, so will the use of robots to stock shelves, prepare food and fulfill many other jobs that relatively unskilled workers used to do. All of this means that income inequality will increase, not decrease, and labor market participation rates will continue to fall.

Another favorite "solution" of many politicians who see the problems as inequality rather than growth is to increase taxes, particularly on the "rich." This movie has been played many times in the past, always with the same disastrous results. Too few people remember what Britain was like before Margaret Thatcher, or what America was like before Ronald Reagan.

Reagan, Thatcher and many other nations' leaders drastically cut tax rates during the 1980s, not because they wanted less revenue for government, but because they realized that after years of stagnation, high tax rates were not producing the revenue they expected. In recent weeks, there have been many calls for higher income-tax rates. This is expected from the political left, but now even some of officials at the International Monetary Fund claim that income-tax rates could be raised as high as 60 percent without serious consequences. (One should always keep in mind that the folks at the IMF and other international organizations are exempt from paying taxes on their salaries. It is very easy to call for higher taxes on someone else — much like President Obama and Senate Majority Leader Harry Reid exempting themselves and their staffs from Obamacare.) What the IMF bureaucrats and many others leave out when they say it is possible to raise more revenue from higher tax rates is that it is only true for a short period of time, before individuals and businesses have a chance to adjust. Serious scholars such as British Nobel Laureate James Mirrlees and others have shown that over the long run, income-tax rates over 20 percent do not raise more revenue once people have adequate time to fully adjust their behavior.

President Francois Hollande of France has just increased the maximum tax rate in France to 75 percent. France also has a wealth tax and many consumption taxes, so the effective tax rate for some wealthy people can exceed 100 percent — and the predictable is happening. The wealthy are leaving France, or at least their wealth and income are. This, of course, means there will be less investment and job creation in France, which already has an 11 percent unemployment rate. It is a safe bet that the economic situation in France will continue to worsen — making it even more of a bad example. One advantage of being "rich" is that you can move your money and your body to places that will treat you well — and there are many such places. Those rich who do not wish to move can and do engage in silent tax strikes, by ceasing to work and invest, and turning to leisure and consumption. Bye-bye, tax base.

The IMF expects that the ratio of public debt to GDP in advanced countries will reach a historic peak of 110 percent next year. Seeing such numbers, some have been calling for global wealth or income taxes. Fortunately, leaders in many countries are not so brain-dead, and they understand that such policies would lead to global economic disaster as more resources are sucked out of the productive private sector into the largely nonproductive government sector. Mr. Obama also said last week that there are "too many outdated government agencies" and that parts of the government are "too big" to manage. Those statements are true. So the president should take the next mental step and recognize that the only solution to the problems of economic growth and debt is to radically downsize government, including tax rates and regulations.

Richard W. Rahn is a senior fellow at the Cato Institute and chairman of the Institute for Global Economic Growth.

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