What Should the Minimum Wage Be?

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In recent years we’ve heard many arguments in favor of raising the federal minimum wage significantly above its current level of $7.25 an hour. Some states (New York and California are the largest example) have adopted legislation mandating an increase in the state minimum wage [2]. In most cases, the proponents of a higher minimum wage argue that it should be set at $15 an hour [3]. But why $15?

One argument often given for raising the minimum wage is that inflation erodes the real value of the wage over time. If one were to adjust the minimum wage for inflation, today’s wage is below what it was decades ago. Thus, the argument goes, the wage should be adjusted to restore its real purchasing power.

The adjustment for inflation is done on the chart below, for the entire period the federal minimum wage existed, using constant 2015 dollars.
Today, the real value of the minimum wage is indeed below what it was in the 1960’s. The minimum wage reached the highest real value in 1968. That year the minimum wage was raised to $1.60, which is equivalent to about $10.80 in 2015. Thus, if the objective is to match the highest-ever real value of the minimum wage, today’s minimum wage would need to be raised to $10.80 an hour. Raising it to $15 an hour would far exceed any past level of real minimum wage.

But why should we raise the minimum wage to match its past real values? In general, workers are not guaranteed that their wages will rise with inflation to preserve their real value, and there is no reason why minimum wage workers should be an exception.

Moreover, other wages are often affected by the changes in the minimum wage. Economists, business owners, and managers long knew that employees tend to pay attention to their relative pay, not only the wage itself. An experienced employee who has been with a company for a few years might feel slighted if he is paid the same wage as the newly hired inexperienced person, even if that wage is $15 an hour. That’s why some argue that increasing the minimum wage [4] would also push up the other wages, higher up the pay scale.

If the question is whether minimum wage workers have lost ground compared to their higher-paid counterparts, let’s look at the historical trends.

The chart below compares the federal minimum wage to the average weekly earnings of production and nonsupervisory employees (the closest approximation to hourly employees that can be found in the data).
Manufacturing provides the longest history of the average hourly earnings. Other sectors have shorter data series, but the overall trend is the same.

Throughout the 1950’s and 1960’s, the average hourly earnings in manufacturing were about twice as high as the minimum wage. In mining and in construction, the average hourly earnings were about 2.5 times higher than the minimum wage.

From the late-1960’s to the early-1980’s the ratio of average hourly earnings to the minimum wage was rising. But since the mid-1980’s that ratio appears to have stabilized. In mining and construction industries that ratio is about 3.5 – the average hourly pay is about 3.5 times higher than the minimum wage. The average hourly pay in manufacturing and in the service providing industries is about 2.8 times higher than the minimum wage.

We can conclude from this chart that the growth in the minimum wage did, in fact, fall behind the growth of other wages, since in recent decades the average hourly earnings exceeded the minimum wage by more than they did in the 1950’s and 1960’s. The minimum wage workers did not see the same wage growth other workers did.

But did the minimum wage fall behind enough to justify an increase to $15 an hour?

If an objective of policy were to rectify the situation and increase the minimum wage to restore it to the same position relative to other wages it enjoyed in the 1950’s and 1960’s, how high would the minimum wage need to be? Since different industries experienced different paces of wage growth, as is evident from the chart, the answer would
differ somewhat, depending on the industry we choose to look at.

But the differences are not drastic – the minimum wage in the range of $10.00-$10.60 an hour would be sufficient to take the ratio of average hourly earnings to the minimum wage back to the level seen in the 1950’s, the time when minimum wage was closest to the average wages.

The data suggest that a minimum wage somewhere between $10 and $11 an hour is sufficient to both restore its position relative to other wages in the economy, and to restore its real purchasing power back to the historical heights seen in the 1960’s. Raising the minimum wage to $15 an hour goes far beyond any past historical experience.

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