A $20 minimum wage but only for some

Joe McGarrity

At the beginning of this year, California's minimum wage was $16 an hour. Then on April 1, California raised its minimum wage for fast-food restaurant workers to $20 per hour but left it at $16 per hour for everyone else. By raising the minimum wage for fast-food workers, California's government helped some workers, hurt other workers, and made the state's labor market needlessly inefficient.

The workers at fast-food restaurants, who keep their jobs, are better off. The reason is obvious. If these workers are going to earn the minimum wage, now they earn more money. In contrast, the people who lose jobs at fast-food restaurants are worse off. Some fast-food workers will lose their jobs because restaurants act like all employers: as the wage rate increases, they want to hire fewer workers. For instance, a worker who is worth $18 per hour to the restaurant would have a job if the restaurant could pay him $16 an hour – the old minimum wage. But when the restaurant was forced to pay all of its employees at least $20 per hour, the restaurant will fire this employee – who, remember, is only worth $18 per hour to the restaurant.

And perhaps obviously, the fast-food restaurants are made worse off by the $20 minimum wage. The high wage reduces the restaurants' profits and reduces the amount of output they can profitably produce.

All of the benefits and costs that I have already discussed would happen with any increase in a minimum wage. What is different about California's situation is that the state has two different minimum wages. This will cause a certain type of inefficiency, one not usually found in across-the-board minimum wage increases.

The two minimum wages will distort California's labor market in a way that keeps workers from taking the jobs that suit them best. To understand this dynamic, consider the following example. Suppose there are two brothers Abel and Cain and further suppose that Abel is more productive and a better learner than his brother. When California had a uniform $16 per hour minimum wage, Abel took a job as a construction worker. He only earned $16 per hour, but the job gave him an opportunity to learn skills that would eventually make him more productive. After learning these skills, Abel would be worth more to the construction company and it would eventually have to pay him a higher salary in order to keep him from taking a job with another construction company. Cain, on the other hand, took a job at McDonald's for $16 an hour but that job did not impart the skills that would lead to increases in his future salary.

But the labor-market distortions began when California adopted a $20 minimum wage that only applied to fast-food workers. Now, in order to gain a higher salary right away, Abel will quit his construction job to take a position at McDonalds. McDonalds, like any firm, is always looking for the best employees, so it will fire the less skilled Cain to free up a position for his more productive brother. Quite obviously, Cain is worse off because he no longer has a job. But society at large is worse off for a less obvious reason.

Because of the $20 minimum wage, society will never get the benefit that comes with Abel developing his skills in the construction industry. He will never learn to work a backhoe because he will be working the fryer at McDonalds. The $20 minimum wage will attract the most capable workers to the fast-food industry. But from society's perspective, it is hard to make a convincing case that this is a good result. Instead, it is much easier to believe that society is better off when capable workers never make career decisions based on which industries must pay the highest minimum wage.

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