

A NOTE ON TEACHING MINIMUM WAGES IN ECONOMICS AND BUSINESS COURSES

DAVID A. DILTS

HEDAYEH SAMAVATI

Indiana University – Purdue University Fort Wayne

ABSTRACT

Since the Krueger article of 2001 concerning the teaching of minimum wages in the principles of economics, “the new economics” seems not to have been widely adopted by textbook authors. A majority of principles of economics textbooks have not adopted the recommendation of Krueger in their presentations of the minimum wage. Perhaps there is a reluctance to take the discussion of the labor market or of government intervention past the purely competitive model; however, such reluctance misses an opportunity to bring relevance to the principles course. The debate concerning poverty, the working poor, the employment practices of Wal-Mart, and a host of other current controversies has led to a renewed discussion of minimum wages. The analysis of monopsony provides an opportunity to apply micro-economic theory to better understand these relevant policy matters.

INTRODUCTION

Alan Krueger’s article in the *Journal of Economic Education* [1] addresses prescriptions for the teaching of the minimum wage since the controversy concerning the “new economics of the minimum wage” arose in the literature in 2000. Card and Krueger [2] reported that an increase in employment was associated with an increase in the state minimum wage in New Jersey. Neumark and Wascher [3] criticized the Card and Krueger [2] results, saying those results were based on suspect data. Card and Krueger then replicated their results using data published by the Bureau of Labor Statistics.

The results reported by Card and Krueger [2] are easily explained by the application of a simple monopsony model of the labor market. The standard textbook treatment of the subject of minimum wages, however, relies not on a monopsony model, but on a purely competitive model of the labor market. Most principles courses in economics rely heavily on the purely competitive model because of its ease of exposition and rather straightforward application to several economic phenomenon that are interesting to the average college student.

The minimum wage is no exception. In a competitive labor market, a price floor (minimum wage) set above the market clearing wage creates unemployment. This is true because some workers get attracted to the labor market by the higher wage but cannot find employment, in Figure 1 ($Q_s - Q_c$). On the other hand, because of higher labor costs, quantity of labor demanded will decrease and some workers will be put out of work, in Figure 1 ($Q_c - Q_d$). The total unemployment created is therefore $Q_s - Q_d$. Those persons who remained employed will be better-off because of the minimum wage, but many of the working poor will be unemployed as a result of the new higher-than-competitive minimum wage. This is the standard result found in principles of economics textbooks.

Card and Krueger's analysis [2] offers instructors of economics a more robust treatment of the labor market. In markets where employers have some modicum of pricing power in the labor market, there is monopsony power. It is not necessary that there be a single employer, whose selfish interests results in exploitation of a defenseless labor force. The simple fact is, employers are assumed to be profit maximizing; and in many small businesses, there is a very direct and visible trade-off between what employees are paid and what is left over for the owner-operator of the enterprise. There is nothing malicious about such distributional effects, it is the way our system really works. When there is

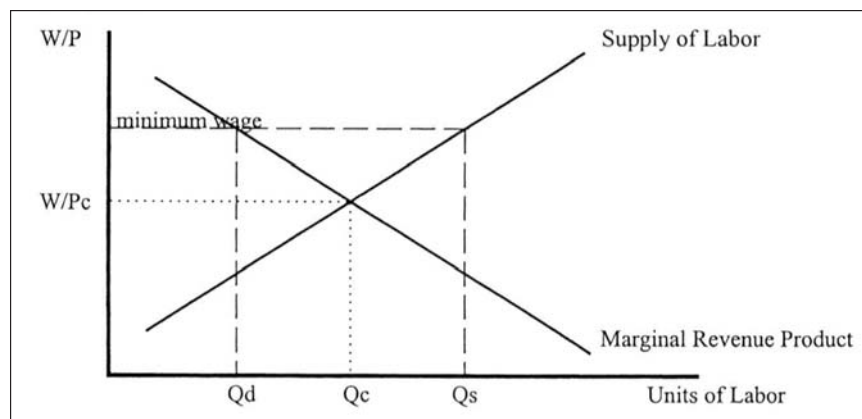


Figure 1. Pure competition in the labor market.

monopsony power in the market, then the competitive model falls short of providing a robust theoretical foundation for analysis, and this should lead to a model whose underlying assumptions fit more with reality. The monopsony model presented in Figure 2 provides for a theoretical explanation that is consistent with the results presented by Card and Krueger [2].

Figure 2 portrays a minimum wage (M) above the competitive equilibrium which results in a level of employment (M) which is greater than that which the monopsonist would otherwise employ (Q), hence an increase in employment consistent with the findings of Card and Krueger [2]. That same result would be obtained in the case of a minimum wage below the competitive equilibrium ($M2$). In both cases, the minimum wage is above that which the monopsonist would pay (W) and the working poor would be better-off.

The end result of this rather simple, straightforward analysis that the issue of minimum wage remains at controversy. What the legitimate role of government is

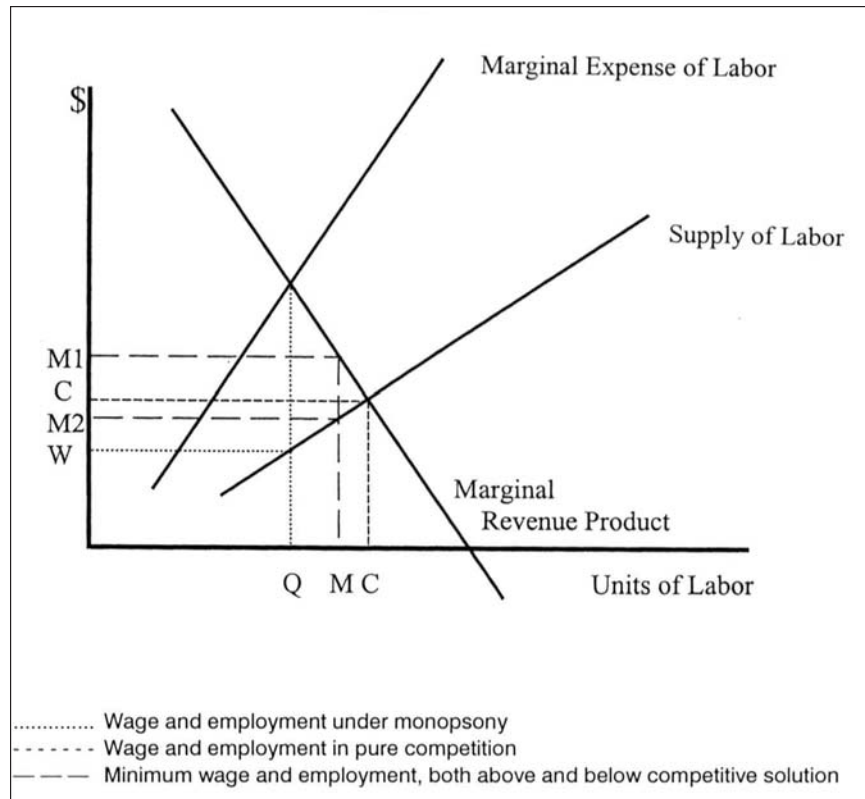


Figure 2. Monopsony in the labor market.

in society is subject to debate, but requires a balanced approach to such economic analyses.

CONTENT ANALYSIS

Saunders and Walstad [4, p. 148] noted that: “. . . criticism emerged at the Purdue conference, including: 1) the need for more real world data in the textbooks; 2) a perception of reduced reliance on graphical analysis in the books in recent years; 3) limited explanation of basic economic measures and statistics; and 4) publication lags in the production of textbooks. Principles instructors can probably find more candidates for the list, especially when the textbooks are examined from a narrow content or ideological perspective.” This analysis is prophetic with respect to the treatment of the minimum wage in recently published principles textbooks.

Krueger [1] examined the treatment of the minimum wage in many of the then-current principles of economics textbooks and found little save the standard purely competitive model being applied to the discussion and a lament about how the working poor, and various other demographic segments of the labor force, fared poorly under such governmental policies. Table 1 presents a content analysis of current principles of economics texts with respect to their treatment of the minimum wage.

In comparing Table 1 with the table of textbook content offered in the Krueger [1] article, it is clear not much progress has been made. While a few other texts have appeared on the market since 2001, it is clear that the majority of principles textbooks have not acknowledged that there is controversy in the profession concerning the standard treatment of the minimum wage. Only one textbook cites the Card and Krueger [2] article and makes comparisons with the results and contentions of Neumark and Wascher [3]. It would appear that the standard treatment is that pure competition is taught and little if any mention is given to evidence that is contrary to the purely competitive treatment in the most widely adopted principles of economics texts.

CONCLUSIONS

It is more than five years since the Krueger article appeared in the *Journal of Economic Education* [1] and more than five years since the open debate in the *American Economic Review* [2, 3], and little has changed in the textbooks concerning the minimum wage. Unless instructors are supplementing the principles textbook they have adopted with articles concerning the minimum wage, it appears that only one side of the minimum-wage debate is being presented.

The evidence is there—it is clear that there is room for debate concerning the minimum wage. There is a responsibility to teach, to foster critical thinking, and that opportunity is being missed with respect to the minimum wage.

Table 1. Minimum Wage Treatment in Principles of Economics Textbooks

Text	Illustrate supply demand	Connection to monopsony	References to literature	Describe nature of evidence	Discuss effect on total payrolls
Ayers and Collinge (2004) [5]	Yes	No	None	No	Yes
Colander (2006) [6]	Yes	No	None	No	Yes
Frank and Bernanke (2007) [7]	Yes	No	None	No	Yes
Krugman and Welis (2006) [8]	Yes	No	None	No	Yes
Leeds, von Allmen, and Schiming (2006) [9]	Yes	Yes	Card and Krueger (2000) [2] Neumark and Wascher (2000) [3]	Yes	Yes
Mankiw (2007) [10]	Yes	No	None	Yes	Yes
McConnell and Brue (2005) [11]	Yes	Yes	None	No	Yes
O'Sullivan and Sheffrin (2005) [12]	Yes	Yes	Joan Robinson (1933) [15]	No	Yes
Parkin (2001) [13]	Yes	Yes	None	No	Yes
Schiller (2006) [14]	Yes	No	None	No	Yes

REFERENCES

1. A. B. Krueger, Teaching the Minimum Wage in Econ 101 in Light of the New Economics of the Minimum Wage, *Journal of Economic Education*, 32, pp. 243-258, 2001.
2. D. Card and A. B. Krueger, “Minimum Wages and Employment: A Case Study of the Fast-Food Industry in New Jersey and Pennsylvania”: Reply, *American Economic Review*, 90, pp. 1397-1420, 2000.
3. D. Neumark and W. Wascher, “Minimum Wages and Employment: A Case Study of the Fast-Food Industry in New Jersey and Pennsylvania”: Comment, *American Economic Review*, 90, pp. 1362-1396, 2000.
4. P. Saunders and W. B. Walstad, *The Principles of Economics Course: A Handbook for Instructors*, McGraw-Hill, New York, 1990.
5. R. M. Ayer and R. A. Collinge, *Microeconomics: Explore & Apply*, Pearson Prentice Hall, New Jersey, 2004.
6. D. C. Colander, *Microeconomics* (6th Edition), McGraw-Hill Irwin Companies, New York, 2006.
7. R. H. Frank and B. S. Bernanke, *Principles of Micro Economics* (3rd Edition), McGraw-Hill Irwin, New York, 2007.
8. P. Krugman and R. Wells, *Microeconomics*, Worth Publishers, New York, 2006.
9. M. A. Leeds, P. von Allmen, and R. C. Schiming, *Microeconomics*, Pearson Addison Wesley, Boston, Massachusetts, 2006.
10. N. G. Mankiw, *Principles of Microeconomics* (4th Edition), Thompson Southwestern, Mason, Ohio, 2007.
11. C. R. McConnell and S. L. Brue, *Microeconomics* (16th Edition), McGraw-Hill Companies, New York, 2005.
12. A. O’Sullivan and S. M. Sheffrin, *Microeconomics: Principles and Tools* (4th Edition), Pearson Prentice Hall, New Jersey, 2005.
13. M. Parkin, *Microeconomics* (5th Edition), Addison Wesley Longman, New York, 2001.
14. B. R. Schiller, *The Microeconomy Today* (10th Edition), McGraw-Hill Irwin, New York, 2006.
15. J. Robinson, *The Economics of Imperfect Competition*, Macmillan, New York, 1933.

Direct reprint requests to:

Dr. Hedayeh Samavati
Professor of Economics
Economics Department
Indiana University – Purdue University Fort Wayne
2101 East Coliseum Blvd.
Fort Wayne, IN 46805-1499
e-mail: samavati@ipfw.edu