Written by **Bob Adelmann** on September 7, 2010

Finally, a Sensible Solution to Unemployment

When Kevin Hassett, director of economic-policy studies at the American Enterprise Institute, wrote in Bloomberg.com that "the biggest problem with the labor market right now is that wages are too high," it was the first positive sign of intelligent life in the mainstream media in some time.

Many have written about the damaging effects of minimum wage laws, federal and state unemployment insurance, and other interventions in the labor market that have kept workers out of jobs, including William Hoar, Gary North, Jacob Hornberger, and Walter Williams.

But few have offered free-market solutions to the problem of unemployment in the Great Recession. Until now.

Says Hassett: "Some observations perfectly at home in economics textbooks can be so beastly in practice that nobody is willing to mention them. Ignoring the facts, though, leads to bad policies and … we don't need more of those." He then takes aim at the federal minimum wage law passed during the Bush administration raising the minimum wage to its present $7.25/hour — an increase of more than 40 percent — "during the worst possible time, just as wages should have been reduced." He makes the case that by requiring businesses to pay more for their labor costs by raising the minimum wage merely reduces employment by those workers who aren't worth that wage to the business. He points out that "teenage workers, who as a group fill many minimum-wage jobs, have been hit disproportionately hard by the recession. Teen unemployment has increased from 17 percent in December 2007 to over 25 percent currently. And as reported by William Hoar, "teenaged black males experienced a jump in their unemployment rate to 57.1 percent [just] five months after the latest minimum wage hike kicked in."

Hoar raised the question, "So how much should workers be paid? $100 per hour? $25 per hour? $7.25 per hour?..." Hornberger reminds his readers that such a decision should be a private matter between the worker and his employer.

> In every economic trade, people are giving up something they value less for something they value more. That's why they trade. They aim to improve their economic well-being through the trade.…
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> Suppose, for example, an employer hires a worker at a monthly pay of $1,000. Both sides have gained, otherwise they wouldn't have entered into the exchange. The employer values the money less than he values the work provided by the employee. The employee values the money more than the other things he could do with his time.… All these valuations are entirely subjective.

Hornberger then illustrates his point by telling the fable of a company that hires 10 teenagers at $15 an hour. "The teenagers begin work. One week later, the [government] enacts a minimum-wage law requiring companies to pay their workers $100 an hour."

> The company lays off the teenagers. They go in search of new jobs, but every company tells them

> the same thing: 'It's just not worth it to us to pay you $100 an hour…"
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> For all those people whose labor is subjectively valued in the marketplace at less than the legally established minimum, the minimum-wage law becomes a death sentence.

Walter Williams says that that is almost exactly what happened to American Samoa when the 2007 minimum wage law was enacted. Prior to enactment, employers on Samoa were exempt from the law, and Chicken of the Sea and its competitor Starkist moved their operations there, paying their workers $3.26 an hour at their tuna canneries. In that economy that was a competitive wage, and the tuna industry employed over 8,000 workers.

But when the 2007 law was changed to cover American Samoa, the island's representative, Eni Faleomavaega, said that with passage of the law "it is no longer possible for the federal government to demand mainland minimum wage rates of American Samoa without causing the collapse of our economy." Chicken of the Sea closed their plant and moved its operations to Lyon, Georgia, putting their 2,000 workers out of work. And, according to Williams, "Starkist, Chicken of the Sea's competitor, might leave the island as well. If that happens, increases in the minimum wage will have cost more than 8,000 jobs in Samoa's canneries and related industries; that's nearly half of [the island's] labor force."

Hassett's opening bid is not complete abolition of minimum wage laws, but instead they "should be scaled back to $5.85, its level when the recession began in December 2007…. This could have a big impact on aggregate employment."

It's a baby step to be sure, but at least it's in the right direction. As Dr. Kenneth McFarland said so many years ago, "The first olive out of the bottle is always the hardest."