Introduction to Articles on Missouri's Economic Growth

In this edition of the *Missouri Policy Journal* we publish two more articles from the Missouri Growth Project, an ongoing analysis of factors that may help us understand why Missouri's economic growth lags most other states. The first phase of the Missouri Growth Project focused on the role of education. This phase examines Missouri's labor market to see if there are features that may hinder economic growth.

In his paper "Recent Research on the Minimum Wage: Implications for Missouri," Texas A&M economist Jonathan Meer provides a broad perspective on the history and continuing debate over the minimum wage. His review examines not only previous modeling of the effects of minimum wage, but also the evidence on the wide-ranging effects from increasing the minimum wage. This paper is especially relevant as Missouri policy makers at the state and city levels continue to debate raising the minimum wage.

Meer's research will be eye-opening for those unfamiliar with the history of the minimum wage in the United States. First enacted in Massachusetts in 1912, early proponents of creating a minimum wage believed that doing so would reduce the demand for low-skilled workers: By setting entry-level wages high enough, firms would be unable to hire these workers. Such a policy had clear racist and eugenicist overtones. It also was argued that setting the wage high enough would keep the most unproductive workers in society from competing for jobs with other, more productive labor. The early proponents of a minimum wage had quite a different agenda than those who support such a policy today.

The modeling of minimum-wage effects has long been carried out under the assumption that workers operated at a competitive disadvantage relative to employers. As Meer explains, employers were thought to exert market power to keep wages at an uncompetively low level. Meer argues that this approach misstates the vast majority of employer-employee relations, especially for entry-level, low-skilled workers. Because a majority of minimum-wage workers are employed by small establishments, "it is difficult to imagine," notes Meer, "that a fast-food restaurant on one corner exerts control over the low-skill labor market, as does the fast-food restaurant across the street."

He also notes that much of the discussion over minimum wages ignores the costs to such small establishments. As he puts it, "increased labor costs in the form of a minimum wage increase must drive some marginal firms out, reducing overall employment even if some remaining firms increase their level of employment.” This means that raising the minimum wage, even if it helps *some* low-skilled workers, has the unintended consequence of reducing overall employment among the least skilled, and it negatively effects small firms, reducing the incomes small-business owners who themselves often are eking out a living.

Meer’s survey of the research indicates that the “best case” scenarios often find that the positive empirical effects tend to be small. He argues that this stems from the fact that recent changes in the minimum wage are often small and thus effect only a small segment of the labor force. This is why the recent, relatively large minimum wage increases in Seattle offer useful laboratory conditions to better analyze the effects. In that case Meer reports that researchers found that the effects of the minimum wage increase were sizable, and negative. The evidence is that by raising the minimum wage, there was a 9 percent reduction in total hours worked in low-wage jobs following the first of a series of increases enacted beginning in 2014. As Meer suggests, the relevance of this experiment is especially important for cities like Kansas City and St. Louis. “A growing consensus has emerged that local minimum wage increases affect the location and commuting decisions of low-wage workers” he notes. Moreover, “low-skill immigrants are less likely to locate in areas with high minimum wages” choosing instead to commute out of such areas to other employment.

In the end, Meer’s analysis indicates that “the purported benefits of an increase in the minimum wage do not generally accrue to low-income households,” and “despite the hopes of advocates that minimum wage increases will reduce reliance on government income-support programs, that does not seem to be the case.” Not only is increasing the minimum wage harmful to small business owners, but it also does not provide appreciable benefits to the very individuals such increases are alleged to help: low-skilled, low-income workers.

The other article, by Dean Stansel of Southern Methodist University, takes a broad look at the relative competitiveness of Missouri’s labor market. The underlying thesis in his article, “Labor Market Freedom and Economic Prosperity: How Does Missouri Compare?” is that a less competitive labor market, one in which wages are determined by market forces, hampers economic growth. “Could it be,” Stansel asks, “that by increasing the ability of Missouri’s labor force to more freely negotiate wage contracts and agree with employers on working conditions the state could realize improved overall economic conditions?"

With this question, he investigates the relative "freedom" of Missouri's labor market. Freedom, as defined by Stansel, is characterized by a setting in which individuals are able to make decisions for themselves, such as wage rates, and engage in voluntary transactions, such as agreeing to work, or not, for this or that employer. To assess how free Missouri's labor market is, Stansel uses data from the *Economic Freedom of North America* (EFNA) report produced annually by the Fraser Institute. Essentially, the EFNA measures freedom by weighing the level of government intervention in the marketplace. For example, a state gets a lower freedom ranking in the EFNA if it is characterized as having a relatively large government sector, high taxes, and a high percentage of total employment in the public sector. In addition, a state would score lower in the freedom index the higher the percentage of total employees that are unionized.

After a review of Missouri's economic record relative to the nation and to neighboring states—and Missouri does not fare well in this comparison—Stansel turns to a comparison of Missouri's level of freedom and employment to the national average and to states in the region. With the evidence showing that states with fewer impediments to voluntary labor market transactions tend to have faster job growth, where does Missouri fall in this distribution of labor market freedom?

Missouri, according to Stansel's analysis of the EFNA data, ranks fairly well. In terms of its overall labor market freedom Missouri ranks seventeenth out of all fifty states. If one uses a broader measure produced by the Mercatus Center at George Mason University, however, Missouri's ranking in terms of labor market freedom drops to twenty-seventh. Not the worst, but not the best either. And how does Missouri fare when Stansel considers several more narrow measures of the labor market? Looking at the minimum wage, Missouri's is below the national average but slightly higher than the average for neighboring states. On the criterion of government employment—do many workers rely on the government for employment versus the private market—Missouri again lies in the middle of the pack: Government employment as a percentage of total employment in Missouri was a little over 10 percent in 2015 compared with about 11 percent nationwide.

Where Missouri's labor market is less friendly to voluntary transaction is the lack of right-to-work laws. Recently rejected by Missouri voters, right-to-work laws increase labor market freedom and are often associated with faster rates of job creation and economic growth. Another area that Stansel looks into is that of occupational licensing. Here Stansel finds that Missouri has the twenty-second most burdensome licensing laws in the nation. The inability to enter a profession due to a licensing restriction inhibits the labor market from allocating resources—in this case workers—to their most highly valued use.

Stansel's overall conclusion is that there are several areas in which Missouri policy makers could reduce constraints on the labor market. Right-to-work laws is one area. Lower taxes is another, especially since Missouri's individual income taxes are high relative to its neighbors. Removing obstacles to market forces, such as eliminating the minimum wage (a policy action that is consistent with the findings of Meer) and reducing occupational licensing would, according to Stansel, improve labor market freedom in Missouri and, over time, enhance economic opportunities. "Since Missouri's economy has been lagging behind in recent years," Stansel observes, "that would be a welcome change for the Show Me State."

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