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Something to Think About

OAKWORTH CAPITAL BANK

COMMON CENTS

Yesterday, Seattle mayor Ed Murray proposed a plan to raise the minimum wage in that city to $15/hour, to be phased in over 7 years, depending on the size of the company. Firms with greater than 500 employees, nationally, have 3 years to make it happen. Those that offer health insurance get another year, and firms smaller than 500 American employees get the full 7 years. After that, the powers that be will adjust the minimum wage for inflation.

From the news reports I have read, it seems this had some sort of endorsement from Seattle's business community; methinks it was less of an endorsement than an admission of the inevitable. After all, it often doesn't matter what the rules are, as long as everyone knows exactly what they will be. Then you can decide if you want to play the game.

When I read the news story, my first thought was the front page of the Seattle Times business section roughly 12 months from now, if that: "Local Franchise Owners Busy Installing Self-Serve Kiosks in Area Restaurants." This soon to be followed by: "Hold the Pickles, Hold the Lettuce, Special Orders Don't Upset Us? Not Any Longer at Local Fast Food Establishments."

Since I am on a roll, or think I am, here is another: "Seattle Sees a Surge of Unskilled Workers Looking for Jobs That No Longer Exist Thanks to Robots."

Proponents of the $15/hour minimum wage certainly have their hearts in the right place. If only we could wave a magic wand and everyone could live the American Dream. Unfortunately, things aren't that simple. The real world operates much differently than our collective interpretation of Utopia or Eden.

As I have mentioned previously, contrary to popular belief and the popular media, most business owners aren't real life Scrooge McDucks, Donald Duck's parsimonious maternal uncle. The same could be said of most publicly traded companies. However, the goal of any business, even non-profits, is to make money. You do so by having revenue that is higher than your costs. Since, employee related expenses are often, usually, one of the largest line items on the income statement, businesses and business owners walk a fine line in generating as much output as is possible for the amount of money it pays per employee. Believe it or not, the cost of the labor per hour is not as important as the output associated with it.

For instance, imagine you have two employees: one makes $10/hour, and can produce 10 units in that time. Another makes $15/hour, but can produce 20 units. Which is the more cost effective employee? Assuming all other things being equal, the one making $15/hour is a more valuable employee, regardless of their higher cost, and will be the one you keep should you have to fire one or the other.

Inside this issue:

If life were fair, Elvis would be alive and all the impersonators would be dead.

Johnny Carson

Something to Think About Cont.

A couple of years ago, my son played on a post-season, tournament baseball team. John was a good little league player, but so were the other kids. When he didn't get the playing time either he or I would have wanted, it was difficult for me to go to the head coach and complain: he wasn't that much better nor that much worse than anyone else, and he was playing more than some others in any event. Still, the team didn't perform as well as the parents would have liked, what for their time and monetary commitment. As it is always easier to coach or parent from the sideline, sure, I would have done some things differently, but I wouldn't have been able to guarantee any more success than the team was having, or had.

Still, it seemed some kids were getting somewhat preferential treatment, based on what I concluded was a preconceived perception of their abilities. Another father and I would discuss this, at some length I assure you, and he ultimately said something that stuck with me: "You know, John, the problem I have with this team is all the kids are basically fungible. Why should X play every inning and bat Y, when B is sitting on the bench more than half the game?"

Fungible. It is a good word, which means interchangeable. In this instance, with the exception of 2 players out of 12, I will grant, the rest of the kids were easily within 1 standard deviation of one another in terms of ability, if that. So, why were some kids sitting more than the others? Let's just say I am happy I no longer have to deal with such questions, as little league baseball will turn ordinarily sane grown men into raving lunatics.

Whether the mayor the Seattle understands such things, unskilled labor, workers which don't have a specific skill which can't be found elsewhere at the same wage or less, is, really by definition, fungible. If the market clearing rate for otherwise unskilled labor in Seattle is less than $15/hour, even in 7 years, increasing the minimum wage to that level won't increase marginal output and company efficiency. Essentially, without a commensurate increase in output, a mandated increase in employee related costs is anathema to the bottom line of any organization.

As a result, companies in Seattle will look for ways to control their SG&A (selling, general, & administrative) expenses in other ways. This may take the form of outright firings, or it could mean a reduction in company benefits, like a match on the 401K plan, a decrease in what the company pays towards health insurance or continuing education, etc. Who knows? Perhaps the company will sit on year-end bonuses and merit increases for the remainder of the workforce. There are a lot of ways for companies to constrain costs outside of outright terminations, which business owners would like to avoid for a lot of reasons.

However, more than likely, companies will bide their time, and eliminate employees through attrition over the next 7 years or so, and/or a reduction in hours worked. It is generally accepted the turnover rate for unskilled labor is higher than for skilled. As these employees quit or change jobs, employers will increasingly replace them with some form of technology, like self-serve kiosks, or not replace them at all. Further, just as some places charge extra for adding, say, cheese or bacon to your burger, they can just as easily charge for taking stuff off. For instance, it might cost you an extra 50¢ to get the #1 combo without pickles and mayo. Perhaps Domino's and/or Papa John's, et al, will charge you an extra $1 per pizza for a phone order, as opposed to placing it online.

After all, if your unskilled workforce is, well, fungible at $10/hour, it is economically destructive at an artificially set $15. Business owners/managers will HAVE to make up that $5 in some form or fashion, or risk detrimentally impacting their potential profit...which is the reason why they are in business in the first place. Raise prices? Maybe, but companies can't control revenue as much as they can cost. If companies could control their revenue, and raise their prices to meet an increase in costs, no one would ever go out of business.

With that said, what if the clearing rate for unskilled labor in Seattle is actually close to $15? If so, this mandated increase in the minimum wage will have little to no practical effect. The city government is simply mandating what has already happened, and making 'Atta boy' headlines in the process. Gee, it feels good to be

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generous with someone else's money, doesn't it? However, I have a sneaking suspicion it isn't.

Now, without a doubt, there are those who read the preceding paragraphs open-mouthed and absolutely horrified. Profit isn't everything! People who have never darkened the door of a church, temple, or mosque will paraphrase/quote 1 Timothy 6:10 like wizened theologians: "Money is the root of all evil!" So, how can I be so base? How can I not think about my neighbors? My community?

The idealists in all of us, somewhere deep down inside, agree with these arguments. However, the practical business people inside us also know the truth, the way the real world works: if someone else's definition of fairness mandates a business owner perform in a manner contrary to their own definition of fairness, they will have to be unfair, in some small fashion, to someone else to compensate, be it other employees or clients. After all, you can always artificially increase the cost of unskilled labor on business, but you can't artificially increase its worth.

As a result, here is what happens when the cost of labor is artificially set *(source edgeworthecon omics.com, but it could have been any number of other sources, as this is a pretty standard chart):*

Well, how about that? It would seem we just can't get away from good, old-fashioned economics, and supply/demand curve graphs. IF the government sets the floor for labor costs for unskilled labor ABOVE the market equilibrium price, guess what? We get a surplus of unskilled labor at the new price. That is another way of saying the UNEMPLOYMENT rate for unskilled labor actually goes UP. Huh? But that would be ironic, wouldn't it?

As for everyone making above, in this case, $15/hour, Well, this doesn't really impact them, does it? And it certainly doesn't impact the mayor of Seattle, who makes the equivalent of $86.11/hour, nor the City Council, who make $57.46/hour, according to the city's website.

In the end, what is a fair wage? But, then again, what exactly does fair mean? And do I really want Ed Murray to tell me? You know, if it is my capital on the line, I think I should have a real say in the matter, and not have to acquiesce to the inevitable designs of politicians.

(Expect the debate over minimum wage hikes, living wages, and the like to continue, and even gather speed, as long as we have employment reports like this morning's. Jobs yes, but high wages….no).

Disclosure