# Commentary

**Title:**

*"Why McDonald's Is Wrong About the Minimum Wage"*

**Author(s):**

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In a surprising about-face, McDonald's has reversed its opposition to drastically raising the Federal minimum wage. In 2019 McDonald's dropped its participation in the lobbying effort of the National Restaurant Association opposing the proposed increase to $15 per hour. In January of this year McDonald's CEO Chris Kempczinski told investors that "…McDonald's will do just fine through that."[1] While some companies such as Domino's Pizza have endorsed McDonald's position, others, such as The Cheesecake Factory, have opposed the proposed new minimum.

How should we think of the minimum wage, and is it good for the country as a whole? Is it even good for workers in the affected labor markets? In order to answer these questions we need to analyze how wages are set in a competitive market. The first thing to recognize is that a wage is just another name for a price, the price of hiring one hour's worth of labor. Labor markets can be analyzed using the same tools and techniques used by economists to analyze price in any market, labor or otherwise.

The most famous, and probably the most misunderstood, tool of market analysis used by economists is the model of Supply and Demand. This model attempts to capture the interactions between all the participants in a particular market, and then determine what the equilibrium, or balance, between the parties will be. In particular, for a labor market, we will analyze what the level of wages will be and how many workers firms will choose to hire.

It is commonly assumed that the resulting "balance" between workers and employers will be strongly in favor of the employer and to the detriment of the worker, leaving the worker underpaid or exploited. Under this assumption, the minimum wage is seen as a mechanism to redress the imbalance of power between low-wage workers and their employers, and restoring the wage to its "rightful" level. Under this view, the higher legal minimum wage will have no long-term negative consequences since the minimum wage just returns things to the level that should exist if employers were not taking advantage of their workers.

Is this commonly held belief true? There are strong theoretical and empirical reasons to think not. But, how could it *not* be true? How can a worker with limited skills and education go up against a billion dollar corporation and get a fair deal? While the argument positing worker exploitation has merit in a monopsony situation, the reason why it is generally not true, and
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No doubt, you have already spotted the flaw in this pricing strategy by Chevron. As long as there are other powerful corporations selling gas, Chevron would not be able to impose their preferred $5 price. Once consumers saw that BP, Shell, and other gas stations were charging $2.89, they would skip the Chevron station and frequent the others. Once Chevron saw their sales drop towards zero, you as the pricing manager, would be "forced" to lower your price to the market price. From this simple thought experiment, we can see that corporations actually have very little power when operating in competitive markets since each company's power is offset by the power of other companies.

Labor markets are even more competitive than gasoline markets, and especially so for low skilled workers. There are far more firms trying to hire workers than there are oil companies trying to sell gasoline. To continue with our though experiment, place yourself in the position of Wendy's hiring manager. Wendy's generated $1.7 billion in sales in 2020, so you have the backing of a major corporation. You are only legally required to pay $7.25 per hour under the current Federal minimum wage law. If you could hire the workers you needed at this wage you could make a huge fortune, so you offer this wage in your job ads. How many workers can you hire, and what worker quality will you get? In my neighborhood, Wendy's is actually offering over $10 to start and will pay more for experience. Why does Wendy's (and other fast food outlets) pay so much over the legally required minimum? Is it their benevolence due to great religious conviction, or something more mundane? Economists would simply point to the fact that other firms are also paying above the Federal minimum since there is a shortage of qualified help at that wage.

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them a legal minimum wage above the market equilibrium level.  Certainly, most of us want those who are struggling with low incomes to do better.  Unfortunately, due to the Law of Unintended Consequences, we could do harm while trying to do this good deed.  Certainly we would not today credit a medical doctor's good will if he or she chose to bleed his y wl iow8hnt[y wti(a)6 J0 Ttsnnlm aaam a ls while the full-service model attracts customers with a more pleasant, but costly, dining experience. Since McDonald's already has fewer employees per meal than a full-service restaurant, any increase in the minimum wage will have a smaller impact on them than on the full-service restaurant. As customers reduce their consumption of restaurant meals in general, part of their cost saving strategy will be to switch to the relatively lower cost self-service restaurant and reduce their full-service dining. McDonald's could actually see an *increase* in their sales in response to the higher minimum wage by taking market share from the high cost full-service competitor! This helps to explain the different reaction of The Cheesecake Factory's CEO to the same minimum wage increase. These two firms will experience the proposed wage increase very differently.

In conclusion, raising the minimum wage has great potential to harm the least skilled among us by making low-skilled workers less desirable in the labor market. Jobs at the bottom of the wage scale will pay better, but there will be fewer of them. Advice on whether to support the increase, when it comes from firms who could benefit from it but who won't experience the harm from it, should be taken with a grain of salt.