

HAVE WISCONSIN POLICYMAKERS FORGOTTEN THEIR ECONOMICS?

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An inspection of public policy issues, some recent and others that have been debated for many years in Wisconsin, suggests that state policymakers, elected officials, and union leaders may have forgotten (or never learned) basic economics principles. Perhaps this should not be surprising; studies indicate that the majority of American adults

know alarmingly little about basic economic concepts. For example, a 1999 Louis Harris & Associates study¹ was developed to assess the understanding of basic economics principles, knowledge about the U.S. economy, and key economic terms of 1010 adults in the United States. The results of this study were not encouraging. Adults scored 57% correct on questions designed to measure basic economics knowledge. Further, only 36% of adults recognized that the statement *Money holds its value during times of inflation* was incorrect and 46% of adults did not know that when the federal government's expenditures for the year are greater than its revenue for that same year, there is a budget deficit.

While there is a clear lack of knowledge about rudimentary economics concepts among



the general public, one might expect state leaders and policymakers to offer an exception to this rule, given the unambiguous importance of economic analysis in the arena of public policy analysis. The value placed upon the study of economics in the area of public policy is reinforced by examining the prominent role that economics plays in the curriculum of America's elite graduate

programs in public policy analysis. For example, in Harvard University's famous John F. Kennedy School of Government, three of the six core courses in their Master of Public Policy program are in economics while in the University of Chicago's Harris School of Public Policy five of the seven core courses are economics-related.

Four state issues will be discussed in this paper that indicate the basic rules of supply and demand have not been fully mastered by many of those making important decisions for Wisconsin's future. The issues used as examples of this deficiency in economics understanding among policy makers include: the debate about raising Wisconsin's minimum

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wage, the shortage of qualified teachers in the Milwaukee Public School system, the development of the Park East corridor in Milwaukee, and the shortage of math and science teachers in Wisconsin schools. Likely, any freshmen enrolled this fall in a principles of economics course at one of Wisconsin's colleges or universities could analyze each of these issues and offer a reasonable solution to, or explanation of, the issue. It is unfortunate our state leaders cannot make the same assessment; however, there still may be seats available in some of these courses if they are willing to learn.

Issue #1: Raising the Statewide Minimum Wage

A long debate on Wisconsin's minimum wage has recently concluded with this wage being lifted from \$5.15 an hour to \$5.70 per hour in June of 2005. A second statewide minimum wage increase will occur in June of 2006, taking the Wisconsin minimum to \$6.50 per hour. While credible arguments can be made both for and against raising the state's minimum wage on various grounds, it was remarkable to stand on the sidelines and view this debate—not once witnessing the most basic argument against raising a minimum wage expressed. A simple online search of the *Milwaukee Journal Sentinel's* web page identified 93 articles and editorials written on this topic since the first of this year, yet not one of these stories even mentioned the likely unemployment increase that this wage hike will cause. An even more compelling aspect of this argument is the fact that this increase in unemployment will almost certainly be disproportionately experienced by low-income workers, the very constituency that supporters of this legislation claim to be out to help. Just last summer, Federal Reserve Chairman Alan Greenspan offered the following words of caution to members of Congress, pointing out that raising the minimum wage, "increases unemployment and, indeed, prevents people who are at the early stages of their careers . . . from getting a foothold in the ladder of promotions."²

The reasons for this unintended economic consequence from raising the statewide mini-

um wage are self-evident to anyone with even a basic understanding of the laws of supply and demand. Recall the traditional supply and demand diagram, with price (wage in our example) plotted along the vertical axis and quantity (number of workers in our example) plotted along the horizontal axis, that nearly everyone has learned about at one time or another in some economics course they have taken. Further, imagine an upward sloping labor supply curve reflecting the fact that more people want to work for a higher wage and a downward sloping labor demand curve showing that firms want to hire less workers at the highest wages. The intersection of these two lines is where the wage is set in a competitive labor market. When wages are too high (above this intersection point) more workers want to work at this wage than there are firms that want to hire them for this pay level—this causes downward pressure on wages and eventually these displaced workers find jobs at the new lower wage. Below this intersection, wages are too low and firms cannot find enough workers to take the jobs at this wage level—causing the market wage to eventually rise.

Now, visualize a line drawn above this intersection point below which wages are not allowed to fall. How is this different from the example presented earlier where wages were too high? The answer is that it is not markedly different other than the fact that in this case the surplus of workers is caused by a government mandate that will not adjust to solve the problem—leading to unemployment. Many economists have studied the impact of minimum wage laws on teenage and low-income employment, those most likely to be employed in jobs where the minimum wage is paid. These studies typically find that a 10% increase in the minimum wage causes a 1% to 3% decrease in employment.³ By the summer of 2006, Wisconsin's minimum wage will have been increased by about 26% over the 2005 level. Simple economics tells us that we should expect between 2.5% and 7.5% of Wisconsin's low income and teenage workers to be adversely affected by this legislative action.

Issue #2: The Shortage of Qualified Milwaukee Public Schools Teachers

Over the years, the Milwaukee Public Schools has faced difficulties in hiring and retaining certified teachers. In 2003-2004, Milwaukee had nearly the lowest percent of fully licensed teachers among all regular Wisconsin public schools districts.

The Wisconsin Department of Public Instruction reported that 88% of the Milwaukee Public School teachers were fully licensed. Other Wisconsin public districts had an average of 97% of teachers who are fully certified teachers. The districts with lower percentages than Milwaukee were in very rural districts such as the Mellen School District (83%). The Madison Metropolitan Public School District reported that 97% of its teachers listed as fully certified.

Milwaukee also ranks low in the state in terms of its ability to retain teachers with five or more years of experience. In Milwaukee, 64% of the teachers have five or more years experience in the district. Other Wisconsin public districts had an average of 83% of teachers who have five or more years of experience. The Madison Metropolitan Public School District reported that 74% of its teachers have five or more years experience in the district.

Why does the Milwaukee Public Schools face difficulty hiring and retaining certified teachers? Several explanations are offered. Common explanations are that potential teachers might be discouraged from applying because large urban school districts such as Milwaukee have many students who are in poverty. Teachers in large urban districts also have to deal with the bureaucratic nature of such school systems.

But Milwaukee faces one additional barrier that no other district does. Milwaukee is the only district in the state, and one of a handful in the nation, that has a mandatory residency requirement for teachers. Since the late 1970s, Milwaukee teachers have been required to live within the borders of the city as a condition of employment. How would a residency rule make a tough hiring situation even worse?

Once again, some basic economics helps to explain this outcome. In theory, a residency requirement causes a decrease in the supply of teachers. Teachers already face barriers to entry such as earning a college degree and holding a state certification. The imposition of a residency rule adds an additional, potent barrier.

A decrease in supply results in an increase in the wages demanded by teachers. Teachers expect to be compensated for the additional burden placed on them by the residency requirement. If the increased wage is not met, these teachers are more likely to accept jobs in public school districts that are in competition with Milwaukee Public Schools, or they may decide to test the labor

market in charter schools within the city that do not have to abide by the residency requirement. Charter schools often have a great deal of flexibility in meeting wage demands of teachers. The Milwaukee Public Schools has an inflexible system of teacher compensation established by its agreement with the Milwaukee Teachers Education Association. Thus, it is difficult for the District to respond to the increase wage demanded by teachers. The result is, of course, a shortage of certified Milwaukee Public Schools teachers.

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Issue #3: The Development of the Park East Corridor in Milwaukee

Over two years ago, the Park East freeway was removed on the north side of downtown Milwaukee to create over 26 acres of land that could be redeveloped for both residential and commercial purposes. The motivations behind the destruction of this freeway included the belief that the physical barrier created by this freeway stunted the growth of adjacent city neighborhoods and the expected increase in property tax collections available to local governments from the newly developed land being back on the property tax rolls.⁴

Of the land available for development in the Park East Corridor, the City of Milwaukee owns less than one acre while Milwaukee County owns sixteen acres. The remaining developable land is privately owned. Given the rarity of such a large parcel of vacant land in the downtown of a major American city, it was expected that real estate developers would line up to bid on projects for this new neighborhood. The removal of this freeway created hope that up to \$300 million in new commercial and residential projects might be developed.

In reality, the opposite situation has occurred. Nearly two years later, virtually nothing has been done with this prime real estate in downtown Milwaukee. Why is this? Once again, basic economics provides part of the answer to this question.

Once the Park East freeway was demolished, local politicians turned their attention to crafting “community benefits agreements.” These types of agreements typically require developers to do a multitude of things including: paying union-scale “prevailing wages” to workers and developing affordable housing options. The Milwaukee Common Council chose not to require the community benefits agreement for their Park East land; however, the Milwaukee County Board had other ideas.

On the sixteen acres of land that Milwaukee County owns in the Park East corridor, a community benefits agreement was

approved over the objections, and veto, of Milwaukee County Executive Scott Walker.⁵ This benefits agreement included the prevailing union wages clause, mandates to build affordable housing and encouragements to build “environmentally friendly” developments in addition to other onerous rules and regulations.

What does all of this have to do with basic economics? How does it help to explain the lack of development in this seemingly ripe-for-growth area of Milwaukee? Every principles of microeconomics textbook includes a chapter on supply and demand. In the section on supply, students learn how firms decide how much of their good or service to supply. Let’s think about this concept from the standpoint of a company that produces and sells ice cream. What are the important factors that firms consider when deciding how much to produce? Obviously, the price of the good or service is of interest to them. In fact, economic theory says that the higher the price, the more ice cream the firm wants to supply, as a higher price makes producing ice cream more profitable. The next determinant of supply is the one that is of interest to our analysis here. The theory of supply says that firms are also concerned with their input prices—how much it costs them to supply the good or service. Our ice cream company would care about the prices of cream, sugar, flavoring, ice cream machines, the buildings used for production, and the labor of workers needed to mix the ingredients and operate the machines. When the price of one or many of these inputs rises, producing ice cream becomes less profitable, and the firm supplies less. If the input prices rise high enough, the firm will shut down and produce no ice cream at all.

This is exactly what is going on with the Park East development. Onerous rules passed by the Milwaukee County Board have made the input costs of “producing” development in the Park East Corridor more expensive by raising wages, controlling hiring, and mandating what can and cannot be built. It should not be surprising to anyone who understands the basics of economics that this policy has led

developers to produce their developments somewhere else, where the input costs are lower, and leave the Park East Corridor a barren wasteland.

Issue #4: The Shortage of Math and Science Teachers in Wisconsin

The arrival of each new school year is usually accompanied by a flurry of news reports describing a looming teacher shortage. Most of these accounts warn that we face a serious shortage of teachers, especially in the areas of mathematics and science. Indeed, data from the Wisconsin Department of Public Instruction in its Supply and Demand Report for 2003 show that chemistry and physics teachers are very rare in Wisconsin. According to the same report, mathematics teachers are often in “chronic undersupply.”

What explains these looming shortages? A recent article in the *Journal Sentinel*⁶ quotes statistics from the Department of Public Instruction and other sources stating that Wisconsin faces an impending teacher shortage due to a large number of impending retirements, insufficient number of new teachers being trained, and fewer college-educated women choosing to be teachers. While these reasons contribute to problems in the labor market for teachers, they do not explain why teachers of some fields—such as physics, chemistry, and math—are hard to find. Once again, a little economics might help.

Teaching is often regarded in the media as one labor market—a market for a generic teacher. In fact, the teacher labor market involves school districts in competition in dozens of other labor markets. A person trained as a physics teacher, for example, has more job alternatives in the private or non-profit sectors than a person who is trained as

an elementary teacher. Similarly, teachers of chemistry, Spanish, and mathematics are often in short supply. Teachers of early childhood, social studies, physical education, and elementary education, however, are much more abundant. In other words, it is more accurate to say that, rather than facing a teacher shortage, Wisconsin faces simultaneous shortages and surpluses of teachers.

What is the cause of these simultaneous shortages and surpluses? It is the widespread use of salary schedules negotiated between boards of education and teacher unions. The salary schedule sets one salary for a generic teacher—as if all teachers had the same mar-

ketable skills and therefore the same opportunity costs. The only variations in the nearly universal use of the salary schedule are provisions of higher compensation for more years of teaching service and for earning more college credits or advanced degrees.

The salary specified for a teacher by the salary schedule is insensitive to the actual conditions in the labor markets in which school districts

compete. For early childhood teachers, for example, the specified salary acts as a price floor. In other words, the salary for early childhood teachers is actually set *above* what the market price would be for a person offering these skills. At this level, the specified salary serves as an incentive to attract more people into the field than there are positions available. The result, of course, is a surplus of early childhood teachers.

The specified salary for teachers is, simultaneously, a cause of the teacher shortages. For physics teachers, for example, the specified salary acts as a price ceiling. In other words, the salary for technology teachers is actually set *below* the market price for a person with

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these skills. This specified salary serves as a disincentive to physics teachers. It discourages people from entering the field because they have better opportunities in other labor markets. The result, of course, is a shortage.

Conclusion

Most Americans know little about basic economics. An examination of four Wisconsin policy issues suggests that Wisconsin's leaders are no more competent in the laws of supply and demand than the general public. This paper makes it clear that to fully participate in the public policy discourse—as a citizen, elected official, union leader or any other capacity—an understanding of the basics of economics should be a requirement.

Notes

1. This firm is now named Harris Interactive and more information about this study can be found at: <http://www.harrisinteractive.com/>

2. Chairman Greenspan's testimony is available from: www.federalreserve.gov
3. For example, see: Charles Brown, "Minimum Wage Laws: Are They Overrated?" *Journal of Economic Perspectives*, 2 (Summer 1998): 133-146.
4. For more background on the development effort of the Park East Freeway corridor see: Mark Kass, "The Park East Runaround: Why Nothing is Happening There," *WI:Wisconsin Interest*, 2005: 14(2), 41-45.
5. Umhoefer, Dave. "Board Overrides Park East Veto" *Milwaukee Journal Sentinel* (posted February 3, 2005).
6. Dresang, Joel. "A+ Demand: Teacher Shortages Forecast" *Milwaukee Journal Sentinel* (posted March 25, 2005).