McDonalds Can Afford to Pay More

Microeconomics Internal Assessment

President Barack Obama proposes to raise the federal minimum wage to $10.10 an hour. However, McDonalds claims that this would be an increase in costs of which they cannot afford. The article by Christopher Flavelle on Bloomberg View says otherwise. The minimum wage is an example of a price control. Price controls are set so that prices are unable to adjust their equilibrium level determined by demand and supply. However, price controls can cause in market disequilibrium and therefore shortages or surpluses.

Labor Market with Minimum Wage (Price Floor)

Excess of labor =labor supply =unemployment

Supply of labor

Wm

Price of labor (wages)

We

Demand for labor

Qs

Qd

Qe

Quantity of labor

In this diagram, the minimum wage, Wm, is above the equilibrium wage, We. The quantity of labor supplied at Wm is Qs, which is larger than the quantity supplied when the labor market is at equilibrium. There results a surplus of labor in the market equal to the difference in Qs and Qd.

Many people argue that McDonalds could afford to pay more. When demand is inelastic, an increase in price causes an increase in total revenue. Since PED<1, the percentage change in quantity demanded is smaller. Therefore a 10% increase produces less than a 10% decrease in quantity demanded and total revenue will rise, which proves they can afford the increased price of labor with the added revenue.

Price Elasticity of Demand (PED>1) and Total Revenue

Price of meal ($)

This diagram shows a price change in the upper left portion of the demand curve. Total revenue is represented by the area of the rectangles obtained by multiplying price times quantity. At the initial price and quantity P1 and Q1, total revenue is given by the sum of the rectangles A and B.

C

P2

P1

Q1

Q2

0

A

B

Quantity of meals ($)

When prices increase, demand tends to decrease for regular goods, however it has been said that fast food is not affected nearly so much. They have revenue of $28 billion worldwide and data proves that consumers of fast food are not price-sensitive showing McDonalds could afford to increase their wages. McDonald’s could double its restaurant workers’ pay by simply raising the price of a Big Mac by 68¢, additionally McDonald’s profits are healthy enough to raise wages without raising prices and still remain profitable. Regardless of how profitable McDonald’s is, it’s clear that they could afford to pay their workers more. In addition to this, increasing minimum wage nationally would affect not just the fast-food industry but also the economy as a whole.

On the other hand, The Restaurant Association says its customers are in fact price sensitive. In which case, price is said to be elastic. This means that the amount by which changes in a product’s cost tend to affect consumer demand for the particular good. McDonalds capture the ‘ever-price-sensitive’ consumers through their ‘Dollar Menu & More’; a raise in price could be quite a risk and could potentially mean the loss of these customers. However, the PED (price elasticity of demand) is a measureable phenomenon. Research proves that for restaurants in general, a 10% increase in price leads to a drop of 6% in demand. Hence they will sell fewer meals, and total revenue would decline as a result.

Setting a minimum wage holds many consequences for various stakeholders. Firstly, firms such as McDonalds are generally worse off as they face increased costs of production because of the higher labor costs. This is reflected in the loss of employer surplus. Consumers are also negatively affected due to the increase in labor costs leads to a decrease in supply of products, which causes higher product prices with lower quantities. Whilst the impact on workers varies, some will gain as they receive a higher wage whereas some lose as they may lose their job as minimum wages often lead to additional unemployment.

In addition to this, if McDonalds can not ‘pay more’ due to a minimum wage that is set too high it will have a detrimental effect on the economy overall. This is because it artificially increases costs beyond what is necessary to attract the right labor to the job. This increase in costs will force employers to limit hiring with the consequential effect of unemployment. Ultimately, employers have an opportunity to take their business overseas to cheaper labor markets although you obviously can't do this with a restaurant.

McDonald’s shareholders would also be badly damaged if increased wages reduced profits. Even if the minimum wage rose slowly, for example over three years, the harm could be devastating. If the increase were spread over several years, each company would have the chance to increase prices to consumers in order to offset that expense. However, that assumes consumers will pay higher prices, which may not be the case at all, especially in the case of McDonalds.

Would count: 737

Bibliography:

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Economics for the IB Diploma (second edition) by Ellie Tragakes

Portfolio (SL/HL) -

Criterion A: Diagrams

• This criterion assesses the extent to which the student is able to construct and use diagrams.

Level Descriptor

0 The work does not reach a standard described by the descriptors below.

1 Relevant diagram(s) are included but not explained, or the explanations are incorrect.

2 Relevant, accurate and correctly labelled diagram(s) are included, with a limited explanation.

3 Relevant, accurate and correctly labelled diagram(s) are included, with a full explanation.

Criterion B: Terminology

• This criterion assesses the extent to which the student uses appropriate economic terminology.

Level Descriptor

0 The work does not reach a standard described by the descriptors below.

1 Terminology relevant to the article is included in the commentary.

2 Terminology relevant to the article is used appropriately throughout the commentary.

Criterion C: Application

• This criterion assesses the extent to which the student recognizes, understands and applies economic information in the context of the article.

Level Descriptor

0 The work does not reach a standard described by the descriptors below.

1 Relevant economic concepts and/or theories are applied to the article.

2 Relevant economic concepts and/or theories are applied to the article appropriately throughout the commentary.

Criterion D: Analysis

• This criterion assesses the extent to which the student can explain and develop appropriate economic theories and/or concepts in the context of the article.

Level Descriptor

0 The work does not reach a standard described by the descriptors below.

1 There is limited economic analysis relating to the article.

2 There is appropriate economic analysis relating to the article.

3 There is effective economic analysis relating to the article.

Criterion E: Evaluation

• This criterion assesses the extent to which the student synthesizes his or her analysis in order to make judgments that are supported by reasoned arguments.

Level Descriptor

0 The work does not reach a standard described by the descriptors below.

1 Judgments are made that are unsupported, or supported, by incorrect reasoning.

2 Judgments are made that are supported by limited reasoning.

3 Judgments are made that are supported by appropriate reasoning.

4 Judgments are made that are supported by effective and balanced reasoning.

Criterion F: Rubric requirements

• This criterion assesses the extent to which the student meets the five rubric requirements for the

complete portfolio.

–– Each commentary does not exceed 750 words.

–– Each article is based on a different section of the syllabus.

–– Each article is taken from a different and appropriate source.

–– Each article was published no earlier than one year before the writing of the commentary.

–– The summary portfolio coversheet, three commentary coversheets and the article for each

commentary are included.

Level Descriptor

0 The work does not reach a standard described by the descriptors below.

1 Three rubric requirements are met.

2 Four rubric requirements are met.

3 All five rubric requirements are met.