The verdict on the minimum wage: guilty on all counts

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Some recent research in the US has challenged the long-held view among economists that raising the minimum wage reduces employment. However, most economists continue to hold to the orthodox view, which continues to be confirmed in academic journals. Furthermore, research continues to find other negative effects from the minimum wage that are sufficient to oppose it even if there is no loss of employment.

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US history

The US minimum wage was first enacted in 1938, but applied only to workers engaged in interstate commerce. This meant that the vast majority of workers were exempt from the law. The first data we have on teenage unemployment are from 1948. From then until a significant expansion of the minimum wage in 1956, teenage unemployment was quite low by today's standards and was actually lower for blacks than whites. As late as 1954, the unemployment rate for black teenage males aged 16 and 17 was still below their white counterparts: 13.4% for the former and 14% for the latter. Over the 1948–55 period unemployment averaged 11.3% for black teenage males and 11.6% for whites.

Beginning in 1956, however, when the minimum wage was raised from 75 cents to $1, unemployment rates between the two groups began to diverge. Soon unemployment rates for both black and white teenage males were significantly higher, but more for blacks. By 1960, the unemployment rate for black teenage males was up to 22.7%, while the white rate stood at 14.6%.

In 1961, Congress enacted another major expansion of the minimum wage, bringing employees in large retail and service enterprises under its coverage. Previously, workers in trades such as construction and in establishments such as gasoline service stations had been exempt from the federal minimum wage. The rate was also increased from $1 to $1.15 and to $1.25 in 1963. These actions caused a further rise in teenage unemployment, with blacks again bearing the brunt. By 1963, the unemployment rate for black teenage males was up to 27% and to 17.8% for whites.

Despite such evidence, supporters continued to push for ever higher minimum wage rates. The minimum wage was further increased in 1967, 1968, 1974, 1975, 1976 and annually from 1978 to 1981. At each point the unemployment rate for black teenagers tended to ratchet higher. By 1981, the unemployment rate for black teenage males averaged 40.7% – four times its early 1950s level, when the minimum wage was much lower and its coverage less extensive.

President Ronald Reagan resisted further increases in the minimum wage during his administration. (The 1981 increase was enacted during the administration of Jimmy Carter.) But in 1990, President George Bush acceded to a two-stage increase in the minimum wage from $3.35 per hour, where it had been fixed since 1981, to $4.25 per hour. A study of the 1990-91 minimum wage increase by Donald Deere and Finis Welch of Texas A&M University and Kevin Murphy of the University of Chicago found that it lowered employment by 7.3% for men, 11.4% for women and 10% for blacks.[1]

Economists' views

For decades the prevailing view among American economists has been that raising the minimum wage inevitably would reduce employment to some degree. Some argued that the benefits were worth the cost and there were disagreements about the impact on employment, but almost none challenged the principle that raising the minimum would reduce jobs, especially for minority youth. In 1981, the congressionally-mandated Minimum Wage Study Commission concluded that a 10% increase in the minimum wage reduced teenage employment by 1% to 3%. This estimate probably represented the consensus view among American economists at that time.

In 1996, President Bill Clinton asked the US Congress to raise the minimum wage, which had been fixed at $4.25 per hour since 1991. In addition to the usual arguments about helping the working poor and restoring the real value of the minimum wage, which had been eroded by inflation, President Clinton made the novel argument that a higher minimum wage would not reduce employment.

The Clinton administration challenged the widespread view among economists that an increase in the minimum wage will reduce jobs by referring to the recent work of economists David Card and Alan Krueger, both of Princeton.[2] Their studies of fast-food restaurant employment after New Jersey and California increased their state minimum wages found no evidence of job loss.

However, there were flaws in the data that cast serious doubt on the validity of the Card–Krueger conclusions. In a paper published by the National Bureau of Economic Research, David Neumark and William Wascher re-examined their data, which originally came from telephone surveys. Using payroll records from a sample of the same New Jersey and Pennsylvania restaurants, Neumark and Wascher concluded that employment had not risen after an increase in the minimum wage, as Card and Krueger had claimed, but in fact had fallen.[3] A review of the Card study of California by Lowell Taylor of Carnegie-Mellon University found that the state minimum wage increase had a major negative effect in low-wage counties and for retail establishments generally.[4] Thus Nobel Prize-winning economist Gary Becker of the University of Chicago concluded that 'the Card–Krueger studies are flawed and cannot justify going against the accumulated evidence from many past and present studies that find sizeable negative effects of higher minimums on employment.'[5]

The fact is that virtually every major study that has ever been done has found significant job losses from an increase in the minimum wage, with the rare exception of those done by Card and Krueger. (Krueger served as chief economist for the US Department of Labor during the early Clinton administration.) A survey of earlier studies by the US General Accounting Office in 1983, for example, 'found virtually total agreement that employment is lower than it would have been if no minimum wage existed.'[6]

Despite the Card–Krueger results, the views of most economists have not changed. The September 1998 issue of the *Journal of Economic Literature* contains a survey of labour economists on the employment effects of the minimum wage. When asked to estimate the impact of raising the minimum wage, the average effect was estimated at –0.21%, meaning that a 10% rise in the minimum wage would reduce youth employment by 2.1%. This would seem to put to rest any notion that economists have changed their view that, in general, higher minimum wages reduce employment.

Impact on the poor

The impact on teenagers and the poor remains disproportionate. The –2.1% figure is an overall impact. For those currently earning less than the new minimum wage, the impact is much greater. For example, before the last increase in the minimum wage in 1996, 74.4% of workers between the ages of 16 and 24 already earned more than $5.15, and 4.3% were legally exempt from the minimum-wage law. Thus the employment losses were concentrated among the 21.3% of workers making the minimum wage or slightly more. When one attributes total employment losses entirely to this group, it turns out that the employment loss figure is not –0.21%, but –1.0%, according to economists Neumark, Wascher and Mark Schweitzer. This means a 10% rise in the minimum wage reduces employment by 10%.[7]

A study of the 1996-97 increase by Richard Burkhauser, Kenneth Couch and David Wittenburg found a decline in employment of between 2% and 6% for each 10% increase in the minimum wage. In a study published by the Federal Reserve Bank of San Francisco, Kenneth Couch translated these conclusions into raw numbers. At the low end of the range, at least 90,000 teenage jobs were lost in 1996 and another 63,000 jobs lost in 1997. At the higher end, job losses may have equalled 268,000 in 1996 and 189,000 in 1997.[8]

But even if the minimum wage had no effect on overall employment, there are still strong arguments against raising it. *First*, it is important to understand that the impact of the minimum wage is not uniform. For 98.2% of wage and salary workers in the US, there is no impact at all, because they either already earn more than the minimum or are not covered by it. However, for teenagers, workers in low-wage industries, those without skills, members of minority groups, and those living in areas of the country where wages tend to be lower, the impact can be severe. This is why, historically, economists have always found that the primary impact of the minimum wage has been on black teenagers.

But current unemployment is just a part of the long-term price that teenagers of all races pay for the minimum wage. A number of studies have shown that increases in the minimum wage lead employers to cut back on work hours and training. When combined with the loss of job opportunities, this means that many youths, especially minority youth, are prevented from reaching the first rung on the ladder of success, with consequences that can last a lifetime. Even minimum wage supporters now recognise that this may be the worst effect that it has. For example, in 1992 former Senator George McGovern, a left-wing Democrat, wrote:

> 'Unfortunately, many entry-level jobs are being phased out as employment costs grow faster than productivity. In that situation, employers are pressured to replace marginal employees with self-service or automation or to eliminate the service altogether. When these jobs disappear, where will young people and those with minimal skills get a start in learning the "invisible curriculum" we all learn on the job? The inexperienced applicant cannot learn about work without a job.'[9]

Perverse effects

When people cannot get legitimate jobs, it is not surprising that they turn to crime and the underground economy. Studies by Masanori

Hashimoto of Ohio State University and Llad Phillips of the University of California, Santa Barbara, both show that increases in the minimum wage increase teenage crime. And a study by William Beranek of the University of Georgia found that the minimum wage increases employment of illegal aliens, who are unlikely to report any violations of the Fair Labor Standards Act to the Department of Labor.

Research also shows that the minimum wage increases welfare dependency. A study by Peter Brandon of the University of Wisconsin, for example, looked at welfare rates in states that increased their minimum wages in the 1980s compared with those that did not. In those that did, the average time on welfare was 44% higher than in states that did not. Much of the reason is due to reduced employment opportunities for welfare mothers. In states not raising the minimum wage, half of welfare mothers worked during the years surveyed, while in states that raised the minimum wage only 40% reported working.

Intuitively one would have expected a higher minimum wage to make work more rewarding for those on welfare. However, the interaction of the welfare and tax systems means that some working people are actually worse off after an increase in the minimum wage. Carlos Bonilla of the Employment Policies Institute found a dramatic example of this in California after the minimum wage rose from $3.35 to $4.25. After accounting for the phase-out of AFDC (Aid to Families with Dependent Children, a federal welfare programme), Medicaid and food stamps, and federal, state and local taxes, it turned out that a single parent earning the minimum wage was $1,800 per year worse off after the increase than before.

Indeed, increases in the minimum wage add almost nothing to the incomes of poor families. There are two reasons for this. *First*, employment losses reduce the incomes of some workers more than the higher minimum wage increases the incomes of others. *Second*, the vast bulk of those affected by the minimum wage, especially teenagers, live in families that are not poor. Thus a study by economists Richard Burkhauser and Martha Harrison found that 80% of the net benefits of the last minimum wage increase went to families well above the poverty level. Almost half the benefits went to those with incomes more than three times the poverty level. (The poverty level is about $17,000 for a family of four.) Similar results have been found by economists Neumark, Schweitzer and Wascher.

Furthermore, the minimum wage reduces education and training and increases long-term unemployment for low-skilled adults. Neumark and Wascher found that higher minimum wages cause employers to reduce on-the-job training. They also found that they encourage more teenagers to drop out of school, lured into the labour force by wages that seem high to them. These teenagers often displace low-skilled adults, who frequently become semi-permanently unemployed. Lacking skills and education, these teenagers pay a price for the minimum wage in the form of lower incomes over their entire lifetime.

Given these kinds of effects, it is not surprising, therefore, that the minimum wage has almost no impact on poverty or increasing the incomes of the poor. Although some poor people are better off because they get higher wages, others are worse off because they lose their jobs. Thus one study found that the 22% increase in the minimum wage in 1976 added just $200 million to the aggregate income of those in the lowest 10% of the income distribution. Indeed, much of the benefit of the minimum wage actually accrues to the well-off, whose children get paid more for part-time jobs.

Minimum wage workers

Although proponents of a higher minimum wage often talk about the difficulty of supporting a family on the minimum wage, only a very small number of workers earning the minimum wage actually do so. In 1993 only 22,000 men and 191,000 women nationwide maintained families on a minimum wage job, according to the Bureau of Labor Statistics (BLS).

According to the latest BLS data for 1995, 37% of minimum wage workers were teenagers, probably living at home, and 59% were age 24 or younger. About 17% of minimum wage workers are wives, and thus likely to be secondary earners, and 66% work only part-time. These include students, the elderly with pension or Social Security income, and those simply looking for a little extra cash.

Moreover, these data overstate the number of workers earning only the minimum wage. Some 49% of minimum wage workers, for example, work in the retail trade, such as restaurants, where tips and commissions may add to their income, but are not counted as wages. Also, data on minimum wage workers are based solely on money wages, excluding fringe benefits. Such benefits on average increase money incomes by better than 40%, according to the

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US Chamber of Commerce, thus pushing the total income of most minimum wage workers well above the minimum. As a consequence, many employers respond to increases in the minimum wage by cutting back on benefits.

Employers also respond by cutting back on hours, installing labour-saving equipment and by changing the mix of part-time and full-time workers. This is why it is difficult to find a bank teller or someone to wait on you at the local department store. Between 1963 and 1995 average weekly hours worked in the retail trade, the industry most affected by the minimum wage, fell from 37.3 to 28.9, while hours worked in higher-paid industries such as mining and construction, that are basically unaffected by the minimum wage, increased.

Conclusion

The case against the minimum wage is strong. In fact, it should be abolished. Even the *New York Times*, a paper not prone to making conservative arguments, has said so. As the headline on its 14 January 1987 lead editorial put it: 'The Right Minimum Wage: $0.00.' Indeed, according to Professors Robert Meyer of the University of Chicago and David Wise of Harvard, abolition would actually increase the aggregate income of youth in the US. Raising the minimum wage simply moves further in the wrong direction.

1. Donald Deere, Finis Welch and Kevin Murphy (1995) *American Economic Review*, May, pp. 232–237.
2. David Card and Alan Krueger (1995) *Myth and Measurement*, Princeton, NJ: Princeton University Press.
3. David Neumark and William Wascher (1995) NBER Working Paper No. 5224, August.
4. Lowell Taylor (1993) *Employment Effect in Retail Trade of a Minimum Wage,* Washington, DC: Employment Policies Institute.
5. Gary Becker (1995) *Business Week,* 6 March p. 22.
6. General Accounting Office (1983) *Minimum Wage Policy Questions Persist*, GAO/PAD-83-7, 28 January.
7. David Neumark, William Wascher and Mark Schweitzer (1999) *Economic Commentary*, Federal Reserve Bank of Cleveland, OH, 1 February.
8. Kenneth Couch (1999) *Economic Letter*, Federal Reserve Bank of San Francisco, 19 February.
9. George McGovern (1992) *Los Angeles Times,* 10 November.