Minimum Wage Policy and Research: What’s a Person to Believe?

Stephen E. Baldwin
KRA Corporation

Robert S. Goldfarb
George Washington University

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There has been a recent renewal of interest in minimum wage effects on the part of both policy makers and researchers. The former group includes President Clinton, who, in his January 1995 State of the Union address, called upon Congress to raise the federal minimum. Debate among researchers has been stimulated by several new studies with allegedly different findings about the impact of minimum wage changes from what the prior research literature displayed. Sar Levitan was not a believer in the earlier consensus on minimum wage effects and would have been pleased by the emergence of these new, conflicting results (Levitan and Belous 1979). Moreover, the political debate over raising the minimum that has been intensified by the new research would have appealed to his policy analyst instincts.

We view ourselves as economists interested in the research issues involved and as policy analysts concerned with the effect of additional evidence on the likelihood that the federal minimum wage will be raised any time soon. Each role presents challenges. As economists, the challenge is how to draw sensible inferences from the various contributions to this literature, especially with recent results seemingly contradicting long-held views. As policy analysts, the challenge is how to assess the advantages and disadvantages of increasing the minimum wage, since the new research emphasizes only one of several dimensions in which conflicts and trade-offs exist.

This paper is intended to extend a mostly congenial exchange of views between two economists with different orientations toward minimum wage issues, a discussion between us that has been going on for
over twenty years. Goldfarb has the typical neoclassical economics fellow-traveller's skeptical attitude about minimum wage legislation, based on a healthy respect for the price system. Baldwin is much more favorably inclined toward minimum wages, based on a healthy respect for the institutional complexities of the labor market and the importance of forces typically excluded from the neoclassical framework. Our aims are to discover if we can both agree on some inferences from current and past research and policy debates, to try to identify where and why we continue to disagree, and to specify what information would help resolve these areas of continuing disagreement.

We believe that this topic is quite appropriate to a volume in honor of Sar Levitan. Sar always viewed minimum wage effects and the possible policy efficacy of changing the minimum as important issues. He was always ready to debate these issues with those less sympathetic than he was to the use of minimum wages as a policy instrument. We hope that this article will carry forward that on-going debate in which Sar recurrently engaged. Paying careful attention to empirical evidence is very much in the Levitan tradition, since concern for the integrity and applicability of economic data was a major component of Sar's career.

What the Recent Political Debate has been About

In the twenty-five years from 1960 to 1985, the real value of the federal minimum wage was never less than $4.50 in 1993 dollars. In the last decade, it has remained below that level (Mishel and Bernstein 1995, table 8.42 and figure 30). The minimum was raised and/or coverage was extended in seventeen of the twenty years starting with 1961.¹ There followed nine years during which the nominal value of the minimum was kept at $3.35 per hour, ending with the April 1990 increase to $3.80 and the April 1991 increase to the current level of $4.25.

The Clinton administration has proposed raising the minimum to $5.15 per hour as of July 3, 1996, which would restore much of the purchasing power eroded since the last increase.² The President and Labor Secretary Reich have both drawn attention to recent research, especially that of David Card and Alan Krueger, which does not find
the negative relation between minimum wage increases and employment losses that is a central feature of the prior research literature. Alan Krueger’s recent service as Chief Economist in the Labor Department brought further attention to these results.

The Republican majorities in the House and Senate for the 1995-96 congressional term have constituted a roadblock to the administration’s proposal. The only hearings in the current session were held before the Joint Economic Committee. Although Secretary Reich and Chief Economist Krueger appeared at the first hearing, most witnesses were critical of raising the minimum and of the research that purports to show there would be little cost to doing so.³

The Recent Research: Is There Less Here than Meets the Eye?

Minimum wage legislation can at least potentially affect workers and employers in a number of ways, including the number and quality of jobs, the extent of fringe benefits and on-the-job training, and the distribution of earnings and income. The largest body of economic research on minimum wages has had to do with employment effects. These studies typically use either time series or cross-section approaches. The former approach looks for alterations in level or trend of employment that follow on changes in minimum wages. The latter approach compares employment growth in two or more areas, states or regions that differ in terms of minimum wage regime at particular times. The employment impact of a minimum wage increase is expected to be greatest on the low-wage segment of the workforce, consisting largely of teenagers and young adults, so that both these approaches tend to concentrate on such subgroups.

Charles Brown (1988) summarized some two dozen time series studies of teenage employment. The consensus of this research is that a 10 percent increase in the minimum wage will reduce teenage employment (net) by 1 to 3 percent. The employment reduction is split between increased unemployment and decreased participation in the labor force. As the increase in the real minimum is eroded over time by inflation, employment approaches its previous level. This modest net
reduction conceals possibly larger changes for subgroups of the teenage labor force and other workers.

Another issue is the extent to which minimum wage increases affect the incentives of teenagers to stay in school. Models allowing for skill differences among workers tend to find that already out-of-school youth may be displaced by enrolled teenagers who expand their labor supply in response to the higher wage (Neumark and Wascher 1995).

Another recent study, by William E. Spriggs and Bruce W. Klein, (1994) concurs in the finding of little aggregate employment effects, but makes a different distributional point. Spriggs and Klein focus on the role of the minimum wage in setting low-wage contours, especially affecting the earnings prospects of rural workers and workers with high school educations or less. They find that these workers are likely to be concentrated in jobs whose wages are linked to minimum wage adjustments more strongly than to movements in average wages.

The Consensus on Employment Effects is Challenged

The October 1992 Industrial and Labor Relations Review contained a symposium of papers on minimum wage research, edited by Ronald Ehrenberg.4 The editor summarized one dimension of the findings by writing:

*It is significant that none of the studies suggest that at current relative values of the minimum wage, large disemployment effects would result from modest future increases in the minimum wage—increases up to, say, 10% (p.5, italics in original).*

The article by Katz and Krueger and the two articles by Card represent three of the four empirical studies underlying Card and Krueger's 1995 book, *Myth and Measurement*, which has attracted unusually wide attention for anything written by economists.5 In generating findings that call into question the conventional wisdom of a (small) negative effect on employment from a minimum wage increase, Card and Krueger employ a method that differs from the standard time series and cross section approaches. The Card and Krueger approach uses data that are less aggregated and more focused on a particular minimum wage "episode." This strategy, which they refer to as embodying "natural experiments," involves surveying employment in individual establishments before and after a particular minimum wage event.6 They
argue that if the minimum wage increase is the only or the most important change that has taken place in the relevant labor market, a host of unobservable variables that didn’t change can be netted out.

The most startling findings in *Myth and Measurement* have to do with Card and Krueger’s contention that a minimum wage increase can be associated with an *increase* in employment. The studies reporting this finding have used surveys of fast-food establishments, a major source of low-wage jobs, especially for young workers. As the authors themselves put it:

Our empirical findings can be summarized as follows. First, a study of employment in the fast food industry after the recent 1992 increase in the New Jersey minimum wage law shows that employment was *not* adversely affected by the law. Our results are derived from a specially designed survey of more than 400 restaurants throughout New Jersey and eastern Pennsylvania, conducted before and after the increase in the New Jersey minimum wage. Relative to restaurants in Pennsylvania, where the minimum wage remained unchanged, we find that employment in New Jersey actually *expanded* with the increase in the minimum wage. Furthermore, when we examine restaurants within New Jersey, we find that employment growth was *higher* at restaurants that were forced to increase their wages to comply with the law than at those stores that already were paying more than the new minimum. We find similar results in studies of fast-food restaurants in Texas after the 1991 increase in the federal minimum wage (Card and Krueger 1995, pp. 1-2). 7

Card and Krueger also carry out a number of more aggregate level (time series and cross-state) analyses, which they interpret as showing much less evidence of any statistically significant disemployment effects than the previous literature displayed. It is fair to say, however, that the fast-food industry studies using new data they themselves collected have had by far the most impact.

In the July 1995 issue of the *Industrial and Labor Relations Review*, five eminent labor economists provide comments on Card and Krueger’s work. In alphabetical and page order they are Charles Brown (Michigan), Richard Freeman (Harvard), Daniel Hamermesh (Texas-Austin), Paul Osterman (MIT), and Finis Welch (Texas A & M). Brown, Freeman, and Osterman can be classified as generally support-
ive of the Card and Krueger results and strategy. All three authors praise what Brown calls “the ‘collage’ strategy that the authors employ” (p. 829). This refers to Card and Krueger’s attempt to bring to bear a variety of data, including newly collected survey data employing “natural experiments,” that seem to shed light on the question at hand in a number of different ways and from different vantage points. This use of “many such experiments” to judge the employment effects of minimum wages provokes Freeman to the statement that “their analysis is a model of how to do empirical economics” (p. 831). In contrast, Hamermesh and Welch focus on the shortcomings of the Card and Krueger theoretical and empirical approach, with Hamermesh terming the evidence “fatally flawed” (p. 838), while Welch calls the study of New Jersey and Pennsylvania fast food stores “a monument to poor survey methodology” (p. 848).

Several specific points made by the five commentators are worth noting. First, both Brown and Freeman, while largely supportive of the Card and Krueger results and strategy, note that their estimates are of short-run employment effects; longer-run effects may well turn out to be both negative and larger. Second, Freeman makes a general point consistent with our (the Baldwin/Goldfarb) mindset: public discussion of the minimum wage issue needs to be reoriented away from focusing so narrowly and exclusively on employment effects. Freeman notes in passing that Card and Krueger themselves argue for a reorientation toward broader income-distributional issues. Freeman then goes on to cite “five issues in assessing the policy of using the minimum wage to help low-paid workers” (p. 833). These include, “Does the minimum wage redistribute income to low-wage workers? Does the minimum create outsiders who suffer long term joblessness because of it? Are low-wage workers low-income workers? How do minimum wage policies fit with other economic policies such as Earned Income Tax Credits? Third, Finis Welch carries out a detailed examination of the actual data that Card and Krueger collected in the New Jersey and Pennsylvania fast food establishment study, and on which some of their most striking results depend. He finds patterns in the data that are so anomalous as to call the reliability of the data into serious question.

The variation in the views of the five cited expert commentators, and the reasons their views vary, provide a striking testimonial to the difficulty the economist/policy analyst audience of this literature (and pos-
sibly, therefore, of other large empirical literatures in economics) has in drawing warranted inferences from it. One set of distinguished reviewers tells us the Card and Krueger work represents a "model of how to do empirical economics," while another equally distinguished set tells us their evidence is "fatally flawed," and the study is "a monument to poor survey methodology." Moreover, this last allegation about the research stems from Welch obtaining the raw data and independently evaluating them, something the other commentators (understandably) did not do. But most of us, when confronting a sizable empirical literature and trying to distill from it the weight of the evidence, are not in a position to recheck the original data and the results flowing from them. We are left with the worry that inferences from empirical literatures may in fact sometimes be built on sand.8

Where Does this Leave Us? What is Needed to Make More Informed Decisions about Minimum Wages?

The two of us are in agreement about the following fundamental conclusion: while employment effects are one element in a thorough evaluation of the costs and benefits of a minimum wage policy, there are other significant elements involved in such an evaluation, and these other elements may be more important than employment effects alone.

We are not alone in holding this view. It is quite consistent with Freeman's argument, cited above, that public discussion of the minimum wage issue needs to be reoriented away from focusing so narrowly and exclusively on employment effects. Much more surprising, given the almost exclusive focus in the public debate on the employment effect results in their book, is the fact that Card and Krueger hold a similar view! As they put it, even if one relies on the literature prior to their research, employment effects are small, so that "the minimum wage is mainly a distributional issue—at least in the range of the current U.S. minimum wage" (Card and Krueger 1995, p. 276).9 Card and Krueger also cite other research by DiNardo, Fortin and Lemieux, "that the increase in the minimum wage from $3.35 to 4.25 per hour rolled back a significant fraction of the cumulative rise in wage dispersion from 1979 to 1989."10
Developing a Strategy for Further Research

Our agreement that more is involved than employment effects leads to differences between us concerning which additional considerations might be most crucial. This in turn leads to questions about the sorts of information that might help us to resolve these differences of opinion.

Which considerations do each of us expect to be crucial? It seems best at this point to speak individually.

Goldfarb: My long-held view, espoused since the early 1970s (see note 9) goes as follows. The most plausible case for a minimum wage (and for its periodic upward adjustment) involves the effect it is likely to have on the distribution of income. Disinterested supporters of minimum wages have over the decades tended to view it as an antipoverty device. Card and Krueger also say things consistent with the importance of the income distribution aspects of the minimum wage. Unfortunately, their research and other contributions over the past twenty years (Gramlich 1976; Kelly 1976; Horrigan and Mincy 1993) indicate that any effect of the minimum wage in the direction of reduced inequality and fighting poverty is likely to be minor. Some of the reasons for this are simple: many of those working at the minimum wage are not members of poor families, and many of those who are poor are not working.

One might argue as follows in the face of this very attenuated effect of the minimum wage on the income distribution. “Why not use the policy anyway? It will help some of the working poor, and its disemployment effects are relatively minor.” In my view, one large disadvantage of this argument is that there are people in the policy arena who actually seem to believe that raising the minimum wage is a serious antipoverty device. Having succeeded in raising the minimum wage, the need to do other things to combat poverty may seem less pressing to these underinformed individuals. So, to someone like me who is sympathetic to public policies to combat poverty and aware of the possibility of placeboesque features of minimum wage increases, the cost of pressing for minimum wage increases is that it will dilute the possibility of getting much more effective antipoverty policies adopted. Those interested in really effective antipoverty policies should “keep their powder dry”: that is, they should stop wasting their limited politi-
cal resources on pressing for what is essentially a placebo antipoverty policy, increasing the minimum wage.

_Baldwin:_ While the income distribution has become demonstrably less equal over the past twenty years, I would agree that minimum wage increases are not a very effective policy to reverse those trends. Rather, I base my support for periodic, moderate adjustment to the minimum wage on three other considerations. First, and most important, a statutory minimum is needed as a constraint on the behavior of employers, forming one dimension of the set of labor standards consistent with an advanced society. Sar Levitan, writing with Peter Carlson and Isaac Shapiro (1986), put this point as follows:

The minimum wage law is a statement by society that certain work conditions are unacceptable. The (Fair Labor Standards) Act was necessary when sweatshops were commonplace and remains necessary today. Most Americans work in labor markets that offer protection against undesirable work conditions, but millions work in secondary labor markets characterized by unstable, low-wage employment. These workers need the protection of government to bring their work conditions up to socially acceptable minimal standards (p. 83).

That is, the main justification for labor standards legislation is the existence of a power imbalance at the lower end of the labor market. Persons vulnerable to exploitation tend to have certain characteristics. They are disproportionately female, poorly educated, members of minority groups, and recent immigrants—legal or illegal. Employers who take advantage of this vulnerability also share some characteristics. They are typically smaller firms, not unionized, in rural/southern locations, and in technologically lagging sectors of the economy such as apparel or food processing.

Other dimensions in which protection is needed are child labor laws, health and safety regulations, and prohibitions against employing illegal aliens. The crackdown on garment sweatshops in Los Angeles this summer is just the most recent reminder that some employers are willing to impose virtual peonage on workers whose bargaining power is nil.

Second, the level and distribution of earnings at the low end of the wage scale are affected by movements of the minimum (Spriggs and Klein 1994). It seems particularly relevant when welfare reform is
being sold as a way to get more people into jobs that “making work pay” needs to be considered. A minimum wage is such a policy.

Third, wages have labor supply effects. If we as a society want to encourage low income individuals to work, wage floors may in fact encourage increased labor supply. Alterations in the income disregards and offsets of welfare payments for any earnings often impose effective marginal tax rates close to or exceeding 100 percent. A minimally skilled segment of the population that is required to offer its labor for whatever it might fetch has a depressing effect on a much wider band of the income distribution.

Goldfarb response to Baldwin’s arguments: Baldwin’s first argument concerns a general rationale for labor-protective legislation applied to the “bottom” of the labor market, and the additional consideration of how attractive a minimum wage is as a weapon in that labor protective legislation arsenal. I know of no serious and comprehensive discussion of the pros and cons of minimum wages as labor protective legislation in the minimum wage literature, nor am I aware of serious and continuing debate in the labor economics literature about desirability or lack thereof of labor protective legislation aimed at the “bottom” of the labor market (where “power imbalances” are presumably more likely to appear). While my neoclassical instincts make me skeptical about the general desirability of such legislation, and the minimum wage does not strike me as an obviously efficacious weapon in the labor protective legislation arsenal, Baldwin does raise a line of argument here about labor protective legislation aimed specifically at the “bottom of the market” that existing research does not seem to help us evaluate. Baldwin’s second argument focuses on earnings levels (especially their variance at the low end) as having important labor market effects apart from their direct effects on income distribution. Such effects certainly deserve more attention than they appear to have gotten so far, but in my view we are currently very far from being able to confidently base a minimum wage policy on them.

Baldwin response to Goldfarb’s arguments: Studies of the effect of minimum wages on the distribution of income have in recent years found little or no impact, while finding a minor positive effect on the distribution of earnings. The fact is that only about a third of minimum wage workers are in families where they are the primary breadwinner. However, the absolute well-being of low-income families is improved.
With the development of the Earned Income Tax Credit (EITC) it has become fashionable to disparage the usefulness of the minimum wage. However, the minimum helps unrelated individuals who are not targeted by the EITC but who are an important proportion of the working poor (Horrigan and Mincy 1993).

Horrigan and Mincy emphasize the interaction of differently targeted policies (minimum wage, EITC, welfare) on the behavior of the working poor. They conclude that there are insufficient data available to assess the relative effectiveness of policies aimed at reducing income inequality. However, minimum wage changes do fill in a gap left by the effects of other policies and have a potential to improve labor market equity.

Another student of low-wage labor markets, David Griffith, places even greater weight on the institutional factors. Griffith contends that the neoclassical approach is inadequate for understanding low-wage labor markets for three reasons: such workers are not atomistic free agents, but are constrained by various social relationships; their decisions and employers’ actions are only partly driven by market forces; and, especially in rural areas, the extent of choice facing such workers with respect to jobs and mobility is much less than that assumed by the neoclassical model (1993, pp. 219-221).

Goldfarb’s characterization of minimum wage changes as having a “placebo effect” has some merit, and I agree that excessive importance may have been assigned to minimum wages as an antipoverty tool. However, I don’t agree that there is a zero-sum nature to social policy formation. The 1960s saw the greatest extent of increases in level and coverage of the minimum wage, along with the initiation of the War on Poverty. The 1990s seem to be seeing, unfortunately in my view, a roll-back of antipoverty measures along with a diminution of the real value of the minimum. Political alignments have shifted and different agendas are being pursued across the whole spectrum of social policy.
What Evidence Would We Like to Have to Support/Refute These Two Views?

Given the noisiness of labor market data generally and the small magnitude of minimum wage effects in particular, it seems unlikely that any aggregate study would provide conclusive evidence on (dis)employment effects. Neither of us, for different reasons, is particularly bothered by this, since we agree that researchers and policy analysts need to shift to other, bigger questions. Neither of us would object, however, to seeing more before/after studies of establishment responses that met the criticisms of Hamermesh and Welch, i.e., that focused on hours worked rather than bodies, that identified the same persons to answer the same questions at the two (or more) points in time covered by the studies, and that looked at the establishment’s overall wage structure. Such studies could provide estimates that might speak more eloquently to the disemployment question. It is possible, but not highly likely, that they would also cast light on the position in the income distribution of those affected by minimum wage changes. Continuing monitoring of the effects of minimum wage changes on earnings levels and income distributions is also highly desirable.

The discussion in the previous section also suggests the importance of addressing the dimensions of minimum wage policy that Baldwin stressed, i.e., the social constraints on what employers are able to do. A broader literature would have to be considered or, indeed, created—one that takes an institutional view of how jobs are altered by law and regulation and how firms and workers operate in such a constrained environment. Such an approach would, implicitly or explicitly, involve the value judgements of citizens, policy makers and analysts. Again, this is very much in the Levitan spirit. As Sar wrote two decades ago: “We should not kid ourselves into believing that policy choices and decisions to continue or terminate programs can be made on purely objective “scientific” grounds. In the final analysis, the policy maker will have to depend on value judgment” (1976, p. 10).

NOTES

1. Coverage has been increased over the years along with changes in the level. While about 85 percent of jobs are now covered by the Fair Labor Standards Act (FLSA), employers with annual
sales below a minimum cutoff level (currently $500,000) are exempted. The initial coverage in 1938 of the minimum wage provisions of the FLSA was restricted to employees engaged in or producing goods for interstate commerce. Subsequent amendments extended coverage for example, the 1961 amendments took in workers in large retail and service enterprises, local transit, construction and gasoline service stations, while the 1966 amendments covered state and local government employees in hospitals, nursing homes and schools, and workers in laundries, dry cleaners, large hotels, motels, restaurants, and farms. Other government employees, some previously noncovered retail and service workers, and certain private household workers have been brought under FLSA coverage more recently (Employment Standards Administration, U.S. Department of Labor, undated Fact Sheet History of Federal Minimum Wage Rates Under the Fair Labor Standards Act 1938-1991).

2. The administration proposal was introduced on February 14, 1995 by the Senate and House minority leaders, as S 413 (Daschle) and H.R. 940 (Gephardt). For a summary of other congressional proposals and additional background on minimum wage issues, see Whitaker (1995).

3 Two of the economists who appeared in opposition, Daniel Hamermesh and Finis Welch, also contributed to the July 1995 symposium in the Industrial and Labor Relations Review on the Card/Krueger findings, discussed in the next section.


6 In some of these "natural experiment" studies, a control group geographical area is also used. In this control group area, no increase in the minimum wage (or other minimum wage "event") has taken place.

7 Some indication of the size of the effects Card and Krueger find for the New Jersey-Pennsylvania comparisons may be useful. The federal minimum was raised to $4.25 per hour on April 1, 1991. New Jersey raised its state minimum to $5.05 per hour on April 1, 1992. If one compares full-time equivalent (FTE) employment before April 1, 1992 with FTE employment after the increase, New Jersey restaurants increased their FTE employment relative to Pennsylvania restaurants by 2.76 employees, or about 13 percent, a statistically significant difference. Adding control variables reduces the size of this effect, but it remains significant in some specifications (Card and Krueger 1995, pp. 33-40).

8 One might react that many studies are based on widely used sample surveys such as the Current Population Survey, whose properties are widely studied and well known. Even when studies use the same data set, however, it is often virtually impossible to replicate published results. For a well-known demonstration of severe replication difficulties using a different empirical literature, see De Wald, Thursby, and Anderson (1986).

9. While we share these views with Freeman and Card and Krueger, we came to them decades ago. See, for example, Goldfarb (1974). A major theme of this discussion was the central importance for policy choices in assessing the income distribution effects of minimum wage policies.

References


