

Minimum Wages

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1 Introduction

1.1 The Minimum Wage Controversy

The minimum wage has been a core element of public policy for more than a century. Originating in the 1890s in New Zealand and Australia, minimum wages spread to the United Kingdom in 1909 and to nearly one-third of U.S. states during the next two decades. In 1938, the U.S. Congress passed a federal minimum wage law as part of the Fair Labor Standards Act. Since that time, minimum wages have been introduced in some form or another in numerous other industrialized countries, as well as in some developing countries. As a result, by the 1990s, minimum wages existed in well over one hundred countries from all parts of the world, and the International Labour Organization (ILO) has designated the minimum wage as an international labor standard (International Labour Organization 2006).

Minimum wages were originally proposed as a means to combat the proliferation of so-called sweatshops in manufacturing industries. These sweatshops employed considerable numbers of women and youths and paid them what were generally regarded as substandard wages. In particular, employers were viewed as having disproportionate bargaining power over such workers, and the minimum wage was intended to ensure that they received a “fair” wage for their work. Over time, however, proponents of minimum wages increasingly advocated them as a way to help individuals or families achieve self-sufficiency, and, as a result, coverage of minimum wage laws was extended to men and to workers in most low-paid occupations.

The goals associated with the minimum wage are widely accepted as right and proper. However, there is much less agreement about whether the minimum wage is effective at attaining these goals. Although overwhelmingly popular with the public in the United States,

the minimum wage has, from the time of its introduction, been highly controversial in the political arena. In addition, minimum wages have typically received less support from economists, who from the very beginning of the minimum wage debate pointed to the potential loss of jobs stemming from a wage floor. Despite decades of economic research, policy debates about the costs and benefits of minimum wages continue to the present day.

1.2 Our Research on Minimum Wages

Research on the economic effects of the minimum wage had largely come to a halt in the 1980s, following the publication of the extensive report of the Minimum Wage Study Commission (1981). This landmark report included studies by a virtual “Who’s Who?” of labor economists working in the United States at that time. During that decade, when we were completing our graduate education, the common advice we received was to find some other topic to research, as it seemed that virtually everything there was to be known about minimum wages was covered in the commission’s report or in other research published prior to the report.

However, in our jobs at the Federal Reserve Board in the late 1980s, where we followed labor market developments particularly closely, we were struck by the increasing number of state legislatures that were setting minimum wages above the federal level.¹ In particular, we saw this state-level variation in minimum wages as an opportunity to improve upon the earlier evidence on how minimum wages affected employment. That earlier evidence was largely based on aggregate time-series data, which posed difficulties for reliably estimating the employment effects of minimum wages because of the limited variation in the federal minimum wage and the absence of valid counterfactual information on what would have happened to the economy in the absence of higher minimum wages. Taking advantage of this opportunity, in our first study of the employment effects of the minimum wage, we constructed a cross-section time-series panel of state minimum wages and labor market conditions, which effectively used states without a minimum wage increase as a comparison group for states that raised their minimum wage.

Not surprisingly, perhaps, we were not the only economists who had this idea, and an early set of papers published in a symposium in the *Industrial and Labor Relations Review* (ILRR) kick-started a new

wave of research into the employment effects of minimum wages. This wave of research, which is often referred to as the “new minimum wage research,” has continued unabated, with well over one hundred papers on this topic published since then, both for the United States—where state minimum wage variation has remained a prominent feature of the policy landscape—and for other industrialized and developing countries.

In the mid-1990s, we began to branch out from our original focus on the employment effects of minimum wages to consider their other consequences. This broadening of our research was prompted by our view that evidence on the employment effects of minimum wages is, taken alone, insufficient to inform the policy debate over the effects of minimum wages. In particular, even if minimum wages result in lower employment for low-skilled groups, there may be other benefits of minimum wages that trade off favorably against the disemployment effects, as well as other costs.

This inquiry led us in two directions. First, given the evidence that minimum wages play an important role in youth labor markets, it seemed natural to ask what other consequences they might have for youths. For example, if minimum wages reduce employment, do they also encourage young people to stay in school because of the decrease in job opportunities or to acquire more skills to raise their productivity to a level at which they would not be priced out of the labor market by a minimum wage? Conversely, does a higher minimum wage induce some teenagers or young adults to leave school in the hope of landing a job paying a higher wage *because of* the higher minimum? Similarly, do minimum wages deter firms from providing training to young workers, hence curtailing an important source of future wage growth? And finally, what are the longer-run effects of the minimum wage on the acquisition of skills? These questions had received some attention in earlier research, but as in the case of employment effects, the emergence of the greater variation in minimum wages across states in the late 1980s provided an opportunity to obtain new—and arguably superior—evidence on the effects of minimum wages.

The second direction our research took is one that we regard as especially important from a policy perspective. In particular, we see the principal intent of the minimum wage as helping to raise incomes of low-income families. This implies that the principal criterion for decisions about raising the minimum wage is whether doing so has beneficial effects for the distribution of family incomes—reducing poverty or

increasing incomes at the bottom of the distribution. Again, this question had been considered in research predating the new minimum wage research, but the available evidence was limited and ambiguous.

1.3 Plan of the Book

This book describes the findings of nearly two decades of research on minimum wages. It synthesizes and presents the evidence we have accumulated across nearly thirty research papers and provides a comprehensive discussion of other research that touches on the same questions we have considered, as well as on other topics central to the debate over minimum wages. In much of the book, we emphasize evidence for the United States. However, where possible, we also discuss research for other industrialized and developing countries.

We begin in chapter 2 with a brief history of the minimum wage. Although we touch briefly on its genesis in Australia and New Zealand in the late 1800s, our discussion focuses mostly on the development and evolution of minimum wage policies in the United States, and on the legal and political challenges that accompanied the efforts to enact these policies. In addition, this chapter summarizes the early debate and research among economists regarding the effects of minimum wages, a debate that to a remarkable degree foreshadowed the issues and questions raised in contemporary research.

Chapter 3 focuses on the issue that has dominated research and debate on the minimum wage—its effects on employment. After a brief discussion of the theory of the minimum wage and employment, we summarize the extensive body of contemporary research launched by the 1992 *ILRR* symposium. This literature is so extensive that we limit our discussion to our own research and to what we view as the most important or compelling evidence from the larger body of research.²

In chapter 4, we turn to the distributional effects of minimum wages, focusing first on the relationship between minimum wages and the distribution of individual wages. The substantial increase in wage inequality in the United States in recent decades has brought this issue to the forefront, with researchers asking whether minimum wage policies—in particular, the general stagnation of the federal minimum wage—have contributed to the rise in inequality. In addition, research on the effects of minimum wages on the wage distribution contributes to our understanding of how minimum wages affect the labor market,

and is a precursor to considering the effects of minimum wages on the distribution of family incomes.

Chapter 5 examines the effects of the minimum wage on the distribution of family incomes. We first consider the relationship between low-wage workers and low-income families. Although it has long been recognized that the two are not synonymous, we discuss updated evidence on the extent to which minimum-wage workers are concentrated in low-income families. We then turn to evidence that parallels much of the minimum wage employment literature in terms of empirical methods, but focuses instead on how minimum wages affect family incomes. This analysis considers—although is not limited to—the question of whether higher minimum wages reduce poverty.

The possible effects of minimum wages on schooling and training, and other potential effects of minimum wages on the acquisition of skills, are the topic of chapter 6. We begin by studying the direct effects of minimum wages on schooling, focusing both on their overall effects and on differences in the effects of minimum wages across skill groups. For example, we ask whether minimum wage increases disproportionately reduce employment opportunities for teenagers who have already dropped out of school, and whether higher-skill workers who may be enticed to leave school by a higher minimum wage displace high school dropouts from the labor market. We then turn to the effects of minimum wages on training, a topic that is relevant to individuals whose employment status is not influenced by the minimum wage, but whose terms of employment may be affected. Because the effects of minimum wages on both training and schooling (as well as foregone labor market experience stemming from reduced employment opportunities) may have longer-lasting consequences, we also present evidence on the longer-run effects of minimum wages on workers' wages and earnings even after their wages have risen above the minimum wage.

Our work—and indeed of most of the research on the minimum wage—emphasizes the effects of minimum wages on individual workers and families. But the broader economic effects of minimum wages on profits, prices, and inflation have also been the subject of some research, and chapter 7 discusses this evidence.

In chapter 8, we turn from studying questions about *how* minimum wages affect workers and the economy to questions about the political economy of minimum wages. That is, rather than viewing minimum

wages as mandated wage floors that fall from the sky, we examine the factors that influence the decisions of politicians (and others) to support or oppose higher minimum wages. As part of this inquiry, we also consider why minimum wages remain so popular even though many economists oppose them (although they certainly do not oppose them unanimously). Finally, we also discuss the newest manifestation of mandated wage floors—“living wages,” which are enacted at the city level and cover a narrower set of workers. After a brief overview of evidence on the effects of living wages, we consider similar political economy questions, asking why living wage laws have arisen and why they take on particular forms.

Finally, in chapter 9, we provide a summary of our evidence, offer some concluding thoughts, and discuss implications for public policy.

1.4 Our Approach and Key Conclusions

As we emphasize throughout this book, we believe that questions about the economic effects of the minimum wage need to be resolved empirically. Economic theory is valuable in suggesting testable hypotheses about the potential influences of minimum wages, and in that sense, it helps guide the empirical analysis. But economic theory rarely makes firm predictions about the effects of minimum wages on the outcomes we consider, and in many cases makes no prediction at all. And, even when the theoretical predictions are unambiguous, they rarely tell us about the magnitude of the effect. As a result, in this book we emphasize what the data have to say about various effects of minimum wages, and the corresponding implications both for public policy and for our understanding of how labor markets work.

Based on the extensive research we have done, and our reading of the research done by others, we arrive at the following four main conclusions regarding the outcomes that are central to policy debate about minimum wages. First, minimum wages reduce employment opportunities for less-skilled workers, especially those who are most directly affected by the minimum wage. Second, although minimum wages compress the wage distribution, because of employment and hours declines among those whose wages are most affected by minimum wage increases, a higher minimum wage tends to reduce rather than to increase the earnings of the lowest-skilled individuals. Third, minimum wages do not, on net, reduce poverty or otherwise help low-income families, but primarily redistribute income among low-income families

and may increase poverty. Fourth, minimum wages appear to have adverse longer-run effects on wages and earnings, in part because they hinder the acquisition of human capital. The latter two sets of conclusions, relating to the effects of minimum wages on the income distribution and on skills, come largely from U.S. evidence; correspondingly, our conclusions apply most strongly to the evaluation of minimum wage policies in the United States.

We state these conclusions bluntly here because we believe they are justified based on the evidence. Nonetheless, as will become clear during the reading of this book, research on the many facets of minimum wages is characterized by continuing disagreement and controversy. As a result, we are under no illusion that all readers of this book will agree fully with our conclusions. However, regardless of whether the reader is convinced by our analysis, we hope that our book will be viewed as providing a thorough and dispassionate study of what has become a remarkably extensive body of research.

