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Distribution and Employment Impacts of Raising the Minimum Wage

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Since 1990, there have been four increases in the minimum wage under two modifications to the Fair Labor Standards Act. The first modification resulted in increases of 45 cents in 1990 and 1991, raising the federal minimum wage from \$3.35 to \$4.25. The more recent action provided for increases of 50 cents in 1996 and 40 cents in 1997 to bring the federal minimum wage to its current level, \$5.15.

This *Economic Letter* examines two important issues that arise as policymakers consider additional increases: What is the impact on earnings? What is the effect on employment? This *Letter* also attempts to gauge the possible impacts from the results of research that focuses on the 1990 and 1991 changes.

Earnings impacts

Assessing the impact of the minimum wage on earnings alone is straightforward. The questions to be answered are: Who is affected by the increase? How much of the increased wage bill goes to their households? What proportion flows to poor or low-income households?

An article by Burkhauser, Couch, and Glenn (1996) examines the income distribution impact of the increase in the minimum wage from \$3.35 to \$4.25. The study considers households of affected workers and finds that less than 20 cents of each dollar of the increased wage bill flows to families below the poverty line and that about half of the increased wage bill flows to workers living in families with incomes more than twice the poverty threshold.

Rather than focusing on poverty, other studies examine the position of the families of minimum wage

workers within the distribution of family earnings. Using this method, Bernstein and Schmitt (1998) study the increase in the minimum wage from \$4.25 to \$5.15 and conclude that about one-third of the increased wage bill flows to families in the bottom 20% of earnings.

Both studies indicate that a relatively small proportion of the increased wage bill is received by the neediest families. Based on this evidence, minimum wages may not be an efficient mechanism for assisting poor and low-income households.

Employment effects

Research on income distribution issues related to the minimum wage largely has been conducted separately from analyses of the employment impacts. A previous *Letter* (Valletta 1996) points out that before 1990, most economists agreed that, when minimum wages were raised by 10%, employment among low-skilled groups (e.g., teenagers) declined by 1% to 3%. In the 1990s, however, a number of researchers began reporting that increases in the minimum wage resulted in smaller employment losses. Some also reported that increases in the minimum wage were associated with employment increases (Card and Krueger 1995).

These latter findings have been controversial for at least two reasons. First, some view the notion that minimum wages can increase employment as being inconsistent with fundamental theoretical predictions. According to theory, when competitive firms are forced to pay higher wage rates, their unit cost of production goes up, implying that at a given price for their products, they will reduce production and their use of labor. Because most empirical research before 1990 was consistent with this prediction, the more recent findings appear to contradict not only standard theory but also a large body of empirical research.

From a policy perspective, these recent findings also have been controversial because they imply that raising wages can be conceived of as a costless policy; that is, there is no loss of employment among the groups assisted. While the authors who have reported these findings agree that, at some level, increasing the minimum wage will reduce employment (Card and Krueger 1998), they have argued that the current rate, \$5.15, lies below this level.

While the state of the economy and wage developments certainly can have a bearing on the effects of a given change in the minimum wage, one cannot be confident that the effects would be benign. Therefore, I pose the following question: what would be the implications for employment among teens if the economy were in a range where employment decreases are likely to result from raising the minimum wage?

To answer this question, I draw from a recent paper on the employment effects of raising the minimum wage (Burkhauser, Couch, and Wittenberg 1998a). In that research, a general model of the relationship between employment and the minimum wage is estimated which includes the specific structure assumed by Card and Krueger as a special case. The research shows that the underlying assumptions necessary to validate their empirical specification are usually rejected by statistical tests. The more general model always yields estimates that support the conclusion that raising the minimum wage does reduce teenage employment and that the effects are within the range indicated by most research prior to 1990. That is, raising the minimum wage by 10% reduces the level of teen employment by 1% to 3%.

Using these results, I take the endpoints of the historical range of the predicted impacts of raising the minimum wage on teen employment (a 1% to 3% decline for a 10% increase) and calculate the percentage reductions in teen employment implied by the most recent increases in the minimum wage, from \$4.25 to \$4.75 and from \$4.75 to \$5.15. I also provide calculations of the percentage reduction in employment that would be associated with raising the minimum wage by an additional dollar, from \$5.15 to \$6.15. Finally, I convert those percentage reductions in employment to numbers of jobs lost. (These calculations are explained in detail in Burkhauser, Couch, and Wittenberg 1998b).

Figure 1 summarizes the information from these calculations, which shows that larger percentage increases in the minimum wage are associated with larger reductions in employment. The October 1996 increase in the minimum wage from \$4.25 to \$4.75 was 11.76%. Thus, the corresponding percentage decrease in teen employment relative to what would have been expected in the absence of the policy is 1.2 to 3.5%. In terms of teenage employment levels, this translates into a reduction of 90,000 to 268,000 jobs. The September 1997 increase in the minimum wage from \$4.75 to \$5.15 amounted to 8.42%. Relative to what would have happened in the absence of the increase, one would expect a 0.8% to 2.4% reduction in teen employment or a loss of 63,000 to 189,000 jobs.

Discussions are currently taking place regarding raising the minimum wage from \$5.15 to \$6.15, a prospective increase of 19.4%. Because this increase would be larger in percentage terms than the last two, the predicted employment losses are larger. Using the historical range of predicted impacts, the expected loss relative to what would be expected if the policy were not changed ranges from 2% to 6% of teen employment, or a loss of 145,000 to 436,000 jobs.

Conclusion

What conclusions might be drawn regarding the impact of raising the minimum wage on teenage employment and the efficacy of the policy in assisting the working poor? While economists disagree about the effects of past increases, even critics of the traditional view think we may be near a point where further increases in the minimum wage will lead to negative effects on employment. If that is the case, my calculations indicate that we would expect the loss of 145,000 to 436,000 teenage jobs from raising the minimum wage from \$5.15 to \$6.15. From a base of 15.5 million teens in the U.S. in May of 1998 with slightly over 7 million employed, reductions of this magnitude are certainly meaningful, representing 2% to 6% of employment of that group.

Regarding the income distribution impacts of raising the minimum wage, a variety of evidence indicates that it is an inefficient method of assisting families of the working poor. When researchers examine how much of the increased wage bill associated with the minimum wage flows to families of officially poor workers, the answer is less than 20 cents of each dollar.

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