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A Hearing Before the Subcommittee on Workforce, Empowerment, and Government Programs

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Overview

Sixty-five years ago, pharmacies stocked mercury, heroin, and radon as remedies; few people believed that a fungus-based drug called penicillin could cure anything; and the minimum wage was considered our most effective anti-poverty policy. Doctors prescribing mercury today would lose their license, yet the popularity of similarly counterproductive minimum wage increases endures—despite the existence of proven and successful means of addressing poverty.

The impending national elections, combined with the superficial appeal of a minimum wage increase, has led a number of vocal pundits, policymakers, and so-called "experts" to clamor for an increase in the minimum wage. The proposed increase will not only fail to reduce poverty, but it will also decrease employment opportunities for low-skill Americans—denying many of them the opportunity to stay in the workforce and learn the skills necessary to improve their lives.

Employment Loss

Federal Reserve Chairman Alan Greenspan best summarized the problem with increasing the minimum wage when he stated **"[t]he reason I object to the minimum wage is I think it destroys jobs, and I think the evidence on that, in my judgment, is overwhelming."**[1] Dr. Greenspan was referring to the decades of economic research proving that an increase in the minimum wage leads to overall job loss for affected employees, particularly the least skilled. While opinions may vary among economists as to the severity of the impact, the overall message couldn't be clearer.

The following is a small sampling of the independent research concerning minimum wages:

- In a 2000 study, economists at Cornell University, the University of Connecticut, and the Urban Institute found that a **10% increase in the minimum wage causes a 2% to 6% decrease in teenage employment**, a common indicator of entry-level employment.[2]

- In 2003, Federal Reserve economists reiterated this finding when they showed a 2% to 3% decrease in employment results from a 10% increase in the minimum wage.[3]

- A 1998 survey conducted by economists at Stanford, Princeton, and the Massachusetts Institute of Technology found that the **average economist believes a 10% increase in the minimum wage causes a 2.1% decrease in teenage employment.**[4]

- An evaluation of the 1990-91 minimum wage increase by economists at the University of Chicago and Texas A&M revealed significant reductions in teenage employment. Employment of teenage males fell 5% after the wage hike, while employment of teenage females fell 7%.[5]

Low-Skill Employment Loss

Overall job loss, however, is not the most insidious employment result from a minimum wage increase. The most damaging effect is the fact that **job loss is concentrated on the least skilled employees**—the very individuals supporters of a minimum wage increase are attempting to help. These low-skill employees lose their jobs because of increased competition from more experienced and higher-skilled employees attracted to the new wage. Employers—who attempt to match productivity to wages to the greatest degree possible—are more than happy to hire these new employees. The end result: low-skill Americans face extreme difficulty finding the entry-level employment necessary for future economic success.

In 2004, Duke University economists found that this new competition following a wage increase comes primarily from teenagers in wealthy families entering the labor market and competing with current employees for their jobs. This new competition results in a 2.9% decrease in the probability of finding a job for every 10% increase in the mandated wage.[6] While there is no inherent problem with these teens working, one must question the efficacy and equity of a policy that takes jobs from current employees and redistributes them to affluent teenagers who did not even work at the previous minimum wage.

Earlier research at Cornell University, the University of Connecticut, and the Lewin Group found that vulnerable groups such as young adults without a high school degree, young black adults, black teenagers, and all teenagers suffered significantly more employment loss as a result of a minimum wage increase. For example, the authors found that a 10% increase will result in an 8.5% decrease in employment for black young adults and black teenagers. **This is over four times the employment loss expected for non-black adults and teenagers**.[7]

A Boston University study found that low-skill adults in states that raise their minimum wage are often crowded out of the job market by teens and students.[8] This finding was supported by research from Michigan State University, which found that high-skilled teens, or those who are perceived as "desirable" employees, often displace low-skill employees in minimum wage jobs after a mandated wage hike.[9]

In a cruel twist of fate, University of Wisconsin researchers found that this displacement effect is often concentrated on welfare participants attempting to work their way off of government assistance. **Mothers in states that raised their minimum wage remain on public assistance an average of 44% longer than their peers in states where the minimum wage remains unchanged.** [10]

The loss of low-skill jobs is not a new phenomenon; it dates back to the original minimum wage. The administrator of the Wage and Hour Division of Franklin D. Roosevelt's Labor Department wrote, in a report to Congress evaluating the $0.25 minimum wage, that **"in a number of instances there have been reports that workers who had been receiving less than [the new minimum wage] had been laid off, and replaced by more efficient workers."**[11]

Even supporters of increasing the minimum wage admit this point. The liberal, union-backed Economic Policy Institute stated that a higher mandated wage will "attract good workers and encourage them to provide high-quality services."[12] In that instance, what happens to the employees previously in these jobs? Where are they supposed to learn the skills we all learned in our first jobs?

Studies Purporting No Employment Loss

Recently, a small number of studies have been put forth by economists stating that the minimum wage does not decrease, and may even increase, employment—a result that cannot be explained under the competitive model that has served as the basis for economic thought over the last two-hundred years.

These studies, primarily conducted by Drs. David Card and Alan Krueger, are a testament to poor survey methodology and their results have therefore been discredited by most economists. Respected labor economist Finis Welch summarized the objections best when he said, **"The consensus view has big problems with Krueger's results and methodology.** Alan [Krueger] ought to consider the old saw: If you drop an apple and it rises, question your experiment before concluding that the laws of gravity have been repealed."[13] In this case, the experiment involved poorly-trained survey takers utilizing unclear questions that generated unexplainable changes in the data over the time period studied.

Card and Krueger's later work utilizing CPS data has been reestimated by economists at Cornell, the University of Connecticut, and the Urban Institute. These results found consistent negative teenage employment effects, particularly for blacks and high school dropouts. Overall, the consensus view of the academy has returned to the fact that a minimum wage hike does decrease employment, particularly employment of vulnerable groups such as minorities and poorly-educated individuals.

Where Do The Jobs Go?

You may often hear individuals ask for "real life" evidence of job loss for these low-skill employees. To find such evidence, one need look no further than the double digit unemployment rates facing our nation's most vulnerable employees. While national unemployment was 5.7% in March, **teenage unemployment was 16.5%, and black teenage unemployment was a shocking 29.4%.** Nobel prize-winning economist Milton Friedman explained these high unemployment rates when he stated, "the high rate of unemployment among teenagers, and especially black teenagers, is both a scandal and a serious source of social unrest. Yet it is largely a result of minimum wage laws." Nationwide unemployment rates of this level would cause panic and calls for drastic action. Policymakers, however, are contemplating a minimum wage hike that would only increase unemployment for these groups.

Minimum wage increase advocates claim that job loss does not exist because businesses must hire employees in order to operate. It is true that employers who remain in business—and keep in mind that those businesses who must close their doors as a result of this policy will not fit into this category—cannot simply stop hiring employees. They have and will continue to respond to minimum wage increases by upgrading the skill level of their employees and/or changing the nature of customer service in an attempt to hold down labor costs.

For example, after a wage hike employers seek to take fewer chances on individuals with little education or experience. While the government can mandate how much entry-level employees must be paid, they cannot determine who will be hired at these wages. After each mandated wage hike, employers are newly encouraged to hire the most efficient employee available in an attempt to decrease staff size and related labor costs.

Employers will also look to automate services wherever possible. Self-service gas stations, automated phone operators, automatic teller machines, self-service soda fountains, and self check-out lanes are markers for disappearing of jobs that were once held by low-skill, entry-level individuals. In these positions, employees were once able to gain the skills necessary to improve their future earnings.

Finally, employers will simply cut back on some customer services. It is common for customers at fast food restaurants to bus their own tables. Baggers at many grocery stores have been eliminated. Forced to pay high mandated wages, employers are choosing to cut back on services rather than raise prices. This results in fewer opportunities for low-skill Americans.

Longer Term Effects From Minimum Wage Increases

As these entry-level jobs disappear they take with them a critical gateway into the labor force for low-skill Americans with little or no experience. Former Senator and Democratic Presidential Candidate George McGovern once asked, "Unfortunately, many entry-level jobs are being phased out as employment costs grow faster than productivity … **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?"**[14] Recent research reveals that failing to absorb this "invisible curriculum" causes individuals to suffer significant economic consequences for years after their spells of unemployment.

Economists at the University of North Carolina found that teenage unemployment can decrease future earnings as far as four years into the future. Current unemployment also increases the likelihood that an individual will be unemployed in the coming years.[15] This research documenting the long-term effects of the minimum wage illustrates the importance of employment early in one's working years.

Loss of Benefits

Those lucky enough to retain their jobs after a minimum wage hike don't receive nearly the benefit you would expect. The low-income adult employee who gets a pay raise often loses government benefits like Earned Income Tax Credit (EITC) payments, food stamps, and low-cost health insurance. In many cases, the mythical "raise" an employee receives as a result of a minimum wage hike is largely eaten up by increased taxes and lost benefits.

Separate studies out of New York University Law School and the University of Kentucky found that many beneficiaries of a minimum wage increase face effective tax rates of 90% on increased wages.[16] In other words, **many low-wage employees could receive only 10 cents of every new dollar resulting from a minimum wage increase.**

Who Benefits from A Minimum Wage Increase?

In addition to decreasing job opportunities and failing to provide significant benefits to many intended beneficiaries, the minimum wage is poorly targeted and provides the majority of benefits to non-poor individuals. It is a blunt policy tool, unable to discern between a low-wage employee and a low-income family head. As a result, the majority of beneficiaries of a minimum wage increase are not the "poster-child" single family-heads living in poverty. **Research from Syracuse University shows that 83% of the benefits from the last minimum wage hike went to families above the poverty line.**[17]

According to recent United States Census data, **only 15% of the beneficiaries from an increase in the minimum wage to $7.00 an hour would be single earners with children.** The remaining 85% are either teenagers living with their working parents, adults living alone, or are married with a working spouse. **The average family income for these beneficiaries is over $44,000 a year.** Furthermore, the majority do not work full-time and nearly a quarter work fewer than 20 hours per week.[18]

The poor targeting of a minimum wage results in the majority of benefits not reaching poor families. Research out of Stanford University found that only 24% of the benefits from a minimum wage hike go to the poorest 20% of families, while 35% of the benefits go to the richest 40% of families.[19]

These results should not be surprising, even former Clinton Labor Secretary Robert Reich admitted that "after all, most minimum wage workers aren't poor."[20]

Minimum Wages and Poverty

Economic research clearly shows that the minimum wage, a supposed anti-poverty policy, does not actually decrease poverty. **Research from economists at Ohio University found no connection between a minimum wage increase and decreased dependency.** Examining state level minimum wages, these economists found no significant connection between a minimum wage above the federal level and decreased poverty. For some sub-groups, the authors found that the minimum wage could increase poverty.[21]

These findings were reiterated by noted minimum wage economist Dr. David Neumark when he stated, **"On balance, we find no compelling evidence supporting the view that minimum wages help in the fight against poverty."**[22] The reason for this is that despite the number of people that may be moved out of poverty, job loss pushes even more people into poverty. On net, dependency is not reduced. But labor groups who will benefit from a general increase in market wages continue to push for these ineffective policies.

Importance of Employment

Economic research clearly shows that the disemployment effects and poor targeting of the minimum wage makes it an ineffective poverty-fighting tool. Furthermore, with seven out of eight people who are living in poverty either not working or not working full time, it is clear that employment is the best solution we have for poverty. **Even President Clinton acknowledged this when he stated, "the best anti-poverty program is still a job."**[23] When individuals work, they are able to increase their skill levels and corresponding wages.

Recent research from Miami University of Ohio and Florida State University found that **nearly two-thirds of minimum wage recipients receive a raise within 1-12 months of employment.** These raises are non-trivial. Over the past 23 years, the median annual growth in wages for minimum wage employees has been **nearly six times that of employees earning more than the minimum wage.** While minimum wage employees have enjoyed significant wage growth over the past decades, this wage growth has been even higher since 1998. Between 1998 and 2002—a time period during which minimum wage supporters insinuate that minimum wage employees received no raise—median wage growth averaged 10.4 % for employees hired at the minimum wage compared to only 1.7 % for workers earning above the minimum.[24]

Despite significant wage growth, a small cohort of entry-level employees is unable to acquire the skills necessary to increase their wages. While some may believe these individuals are the justification for a wage increase, the economic reality of the situation is that after a wage increase these low-skill individuals will be the first to lose job opportunities to higher-skilled and more-experienced applicants.

Earned Income Tax Credit

Instead of supporting an ineffective anti-poverty tool, policy makers should support strategies that increase entry-level opportunities for low-skill Americans. The EITC is the most effective anti-poverty program in existence. This credit provides a tax-free cash supplement to the incomes of working families while simultaneously creating an **explicit incentive for increased work effort.** Since the EITC is not available to those without a job, it provides an unambiguous incentive to work.

With its emphasis on work, it is unsurprising that the EITC increases employment. But it does more than that. Research from economists at Michigan State University and the Federal Reserve found that recipients of the EITC increase their work effort and enjoy higher earnings, moving these employees closer to self-sufficiency.[25] The EITC is the only program that accomplishes this dual goal of improving the earned income of recipients while still providing cash assistance. That may be why Dr. Jeffrey Grogger of UCLA stated that "the EITC may be the single most important policy measure for explaining the decrease in welfare and the rise in work and earnings among female-headed families in recent years."[26]

If policymakers are truly serious about providing workable solutions to poverty, they should examine modifications and extensions of the EITC that provide even greater returns through better targeting. These policy changes would actually improve the living conditions of working families in America.

A minimum wage, on the other hand, will not decrease poverty and will limit the employment opportunities of the least-skilled Americans. By denying these individuals early entry to the labor force, the minimum wage will push them further into a life of poverty and government dependence.

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