The economics of a higher wage floor

By Jared Bernstein
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There have been a number of recent articles and commentaries about daylong strikes by fast-food workers demanding higher wages. That has brought out the usual arguments about why we should or shouldn't increase the legal wage floor, which these days comes in various flavors. There's the national minimum wage, which President Obama would like to increase to $9 an hour, there are 18 states (and the District of Columbia) with their own minimums above the federal, and there are many cities with living-wage ordinances, which typically mandate a higher wage floor to workers in a particular sector.

The strikers themselves have articulated why they need higher pay. Many are single parents or second earners from low-income households working in an industry where the median wage is about $9 an hour (and they're not kids; 73 percent of low-wage restaurant workers are at least 20 years old). In speeches over the last few weeks, the president has argued for a higher minimum as a weapon against working poverty.

These ideas typically poll very well. In a Gallup poll in March, 71 percent said the minimum should go up to $9; even 54 percent of conservatives agreed. A recent study of economists, a group congenitally much less predisposed to price mandates (with the wage being the price of labor), also revealed that many were pretty much O.K. with the president's proposal. Less than half agreed that it would hurt low-skilled workers' employment prospects (none "strongly agreed" with that possibility), and among those who professed high confidence in their responses, 62 percent agreed that the benefits of such an increase outweighed its costs.

So, why not just raise the wage floor, right?

Opposition exists, of course, particularly from those whose profits take a hit when their labor costs go up. In fact, while running the other day, I listened to a radio program on which a representative from a think tank with ties to the restaurant lobby trotted out the usual arguments (isn't that what you listen to when you run?).

–If you raise workers' wages, they'll just be replaced by machines. I think of this as the "third-world wage" strategy: let's keep wages low enough so that employers won't invest in labor-saving technology. It's a destructive, low-road idea that's wholly inconsistent with the history of our economy and the people in it, as we've consistently benefited from capital deepening.

Moreover, there's no correlation in the data between periods of high productivity and a shrinking share of low-wage jobs. The fact is, we'll have people working in fast food and retail in good times and bad, in periods of high innovation and otherwise. The question is what the quality of their jobs will be.

–They don't need higher wages; we've got the E.I.T.C. The earned-income tax credit is an important pro-work wage subsidy that's actively lifting the living standards of low-wage workers from low-income families. Since its receipt is linked to income, it's very well aimed at low-income working families. And it adds, on average, about $3,000 to the earnings of low-income workers with children.

But here's the thing. It is not enough to cite the existence of the tax credit as a rationale for not increasing the minimum wage. Those of us calling for an increase in the minimum recognize that the credit is a great complement to the wage floor. But working families need more to get ahead, not just what they have now. So if minimum wage opponents want to bring up the earned-income tax credit, they have to argue for increasing it, and that's an argument I do not hear them make (they also need to oppose efforts to reduce it).

One other point here. I chose the word "complement" above for a reason, one that I think is very important. The earned-income tax credit is great, but let's be clear: it's income redistribution through the tax code. If opponents of raising the minimum wage believe that we can prevent low-wage workers from falling behind on the back of the tax credit alone, they must realize that they're talking about increasing the credit every few years. That's not going to happen, and ultimately, it would imply a large and growing subsidy from taxpayers to low-wage employers. It takes two hands to lift the burden of low pay: the minimum wage and the earned-income tax credit (actually, it takes a lot more hands than that; other work supports, like help with child care, health care, transportation and housing also matter).

–A higher wage floor will hurt its intended beneficiaries, because it forces employers to lay them off. Ah, that old saw. Even most economists don't believe that anymore. Remember way back at the beginning when I told you about all those different states and cities that have their own wage floors above the federal level? Well, that variation has provided something rare in economics: an opportunity for pseudo-experimental tests of the disemployment theory (i.e., we can compare employment outcomes in states with similar economies and different minimum wages). And while there's lots of arguing among economists about the best way to run such tests (surprise!), their results almost all hover around zero.

That's not to say every study finds no effect. Some find positive, some negative. But the reason you get that economists' result cited above about the benefits' outweighing the costs is that these studies overwhelmingly find that on net, raising the minimum wage lifts the earnings and the incomes of a vast majority of affected workers (the economist John Schmitt provides an excellent review of the literature; see his Figure 1 for the "hovering around zero" effect).

Why don't they lose their jobs? In part, because some of the cost of the higher wage comes out of profits, which, as noted, explains the "who and why" of the people fighting the hardest against this idea.

There is this, however: across all of these studies, our experience with higher minimum wages is that the increases don't reach far beyond the low end of the low-wage sector, and thus don't significantly affect employment. Typically, the "affected range" — the share of the work force affected by the increase — amounts to no more than 10 percent of the work force, which is about what you'd get if you phased in an increase in the $9-to-$10 range. To go much higher would take us beyond what we've learned from the research.

So, fear not an increase in the minimum wage. In fact, it's one of the few things we can do that would help a lot of people who are struggling to stay afloat, if not get ahead, and would not increase government spending. I challenge you to come up with a better idea that meets those two criteria.

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