Raising the minimum wage: Old shibboleths, new evidence

By Laura D'Andrea Tyson
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The last several decades have been especially hard on American workers in jobs that pay the minimum wage. Adjusted for inflation, the federal minimum wage of $7.25 an hour today is 23 percent lower than it was in 1968. If it had kept up with inflation and with the growth of average labor productivity, it would be $25 an hour.

Congressional Democrats have proposed legislation to raise the minimum wage to $10.10 an hour and index it to inflation, and President Obama signaled support in a recent speech highlighting the economic and political dangers of growing income inequality. Predictably, opponents of an increase in the minimum wage are once again invoking the hackneyed warning that it will lead to higher unemployment, especially among low-skilled, low-wage workers who are the intended beneficiaries.

I heard the same refrain in 1996 when I served as chairwoman of President Bill Clinton's National Economic Council, and he worked with congressional Democrats to raise the minimum wage to $5.15 an hour at a time when it had fallen in real terms to a 40-year low. To hear Republican opponents and lobbyists for retailers and fast-food companies, we were about to inflict a cold-hearted fate on young people and minority workers. The same chorus is voicing the same dire predictions today.

As it happened, the United States experienced a spectacular boom in employment and prosperity from 1996 to 2000. Indeed, these years proved to be a rare and all-too-brief period when incomes improved at every wage level. Contrary to the warnings of the naysayers, a higher minimum wage did not impede robust employment growth; it did contribute to healthy income gains for low-wage workers. Since then, a raft of meticulous economic research, including work by David Card and Alan B. Krueger, who served as chief economist at the Labor Department in the Clinton administration and more recently as the chairman of the Council of Economic Advisers in the Obama administration, has decisively demolished the old shibboleths. The weight of the evidence consistently finds no significant effects on employment when the minimum wage increases in reasonable increments.

For a good overview, look to a paper by Arindrajit Dube of the University of Massachusetts, Amherst; T. William Lester of the University of North Carolina, Chapel Hill; and Michael Reich of the University of California, Berkeley. Using two decades of data and side-by-side comparisons of bordering counties in the United States, they find that higher minimum wages raise the earnings of low-wage workers and have negligible effects on employment levels. According to their estimates, an increase of 10 percent in the minimum wage would have a statistically negligible effect on employment in industries and occupations employing minimum-wage workers.

In 1996, the prevailing view among economists was that an increase in the minimum wage would reduce employment. But opinions have changed in response to the evidence. In a recent survey of a panel of leading economists, only a third expected that an increase in the minimum wage to $9 an hour would make it "noticeably harder for low-skilled workers to find employment," and nearly half agreed that the economic benefits of raising the minimum wage and indexing it to inflation would outweigh the economic costs.

An increase in the minimum wage would increase the costs of businesses, especially those like fast-food restaurants that employ a large number of minimum wage workers. Higher labor productivity resulting from a reduction in labor turnover brought on by a higher minimum wage would offset a portion of these costs. Businesses would also pass some costs on to their customers in the form of higher prices.

Yet a phased-in increase in the federal minimum wage to $10.10 an hour is not likely to affect business costs or prices significantly. On average, even the costs of fast-food restaurants would increase by less than 3 percent, and a price increase of a few cents on their products could offset a significant share of their higher labor costs. According to a recent estimate, McDonald’s could cover about half of its higher labor costs by raising the price of a Big Mac by about 1.25 percent, or 5 cents.

At the macro level, an increase of 10 percent in the minimum wage is associated with less than half a percentage point increase in the aggregate price level. With short-term nominal interest rates near zero, a transitory increase in the inflation rate from a minimum wage hike would lower the real interest rate, increasing demand and growth.

Another shibboleth of the naysayers of a minimum wage increase is that most minimum wage workers are teenagers. They are not. According to recent research by the Economic Policy Institute, about 30 million workers would benefit from the proposed increase in the minimum wage to $10.10 an hour. Of these workers, 88 percent would be at least 20 years old with an average age of 35; 55 percent would be working full time; 56 percent of them would be female, and more than 28 percent of them would be parents.

At the current minimum wage, a worker employed full time for a full year makes only $15,080, 19 percent below the poverty line for a family of three. So it’s not surprising that many families whose incomes depend on a minimum wage worker need public assistance. More than half of the families of fast-food workers are enrolled in at least one public assistance program at a cost of about $7 billion a year. Recent research finds that an increase in the minimum wage is a powerful policy tool for reducing poverty, with a 10 percent increase cutting the poverty rate by 2 percent.

Putting more income into the hands of minimum-wage workers would not only reduce poverty; it would also stimulate consumer spending at a time when inadequate demand continues to impede a robust recovery and job creation. Using very different methodologies, two recent studies confirm that an increase in the minimum wage to the $10 range would lift spending, gross domestic product and job creation.

Contrary to the warnings of its opponents, a higher minimum wage would, under current economic circumstances, mean more employment, not less.

An increase in the minimum wage would also increase the effectiveness of the earned-income tax credit to reduce poverty and increase demand among low-income households with high propensities to consume. As David Neumark asserts in his recent Economix post, since the mid-1990s, when President Clinton championed a sizable increase in the earned-income tax credit, it has provided much greater income support to low-income families than the minimum wage. But as Professor Neumark acknowledges, the earned-income tax credit and the minimum wage are not substitutes for each another. They work together and can lead to better outcomes than either policy alone.

Unfortunately, it is highly unlikely that a divided Congress will agree to increase the generosity and coverage of the earned-income tax credit any time soon. But the prospects for an increase in the minimum wage look promising because of strong voter support. A recent poll shows that large majorities of Democratic, independent, and Republican voters support an increase in the minimum wage.

As President Obama noted in his speech on inequality, most Americans agree that if you work hard, you should be able to make a decent living and support your family. It's time to raise the minimum wage and make it real.

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