Impacts of a Minimum Wage Increase

National Bureau of Economic Research (NBER) Report Summary

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There has been much discussion in the policy community regarding the impacts of increasing the minimum wage, both in Utah as well as nationally. The federal minimum wage was last raised in 1997 to $5.15 an hour. This eight year stint without an increase in the minimum wage is second in length of time without an increase only to the nine years (1981-1990) during the Reagan and George H. Bush administrations when the minimum wage was $3.35 an hour.

Raising minimum wage levels is probably one of the most partisan economic decisions federal policy makers face. Republicans insist that raising the minimum wage stifles job growth and increases unemployment and inflation. They often point to the economic stagnation of the mid to late 1970s as proof of this theory. This time period was marked by inflation in double digits, an energy crisis and mass layoffs, particularly in steel and other manufacturing industries. It also happened to be the time when the purchasing power of minimum wage was the highest. In 1979, a worker earning the minimum wage of $2.90 an hour had an income equivalent to someone earning $7.55 an hour in today's dollars.

Democrats counter that society has an obligation to provide a “livable wage” to those at the bottom of the socio-economic ladder. They also insist that a rising tide lifts all boats and that all workers benefit from a high wage floor. During the 1970s, a shift in the economy from manufacturing to services as well as the energy crisis had more to do with stagnation in the US economy than did minimum wage.

The economic conditions that exist today are different than those of 1967 when federal minimum wage requirements were extended to most non-agricultural industry sectors. In 1967, over a quarter of all jobs (27.1%) were in manufacturing. Today, that figure stands at 1 in 9-or 10.9%. Conversely, service-sector employment including retail jobs, have increased from 66.8% to 83.4% of total jobs.

This shift from goods-producing to service producing work has also meant a decline in workers paid on an hourly basis. Today, approximately 60% of workers are hourly employees, a decline from the late 1960s. Finally, a smaller and smaller percentage of workers are receiving minimum wage. In 1979, 13.4% of all hourly workers were paid at or below minimum wage. That percentage has steadily declined since. In 2004, only 2.7% of hourly workers received minimum wage or less.

These economic changes, along with the partisan arguments summarized above, lead policymakers to question the impacts of raising minimum wage, not just on the economy but on workers, especially those at or near the bottom of the pay scale. Studies in this area have mainly focused on impacts of minimum wage increases on teen and young adult workers, since they do comprise the majority of those working for minimum wage. Additionally, these studies have usually focused on only one aspect of employment change: wages, hours worked, job loss or income, not all simultaneously.

A study done by researchers for the National Bureau of Economic Research (NBER) in 2000 was an attempt to resolve some of these discrepancies in minimum wage research. The findings of the researchers are worth consideration and will be summarized here. To download and review
The study focused on initial impacts as well as the "lagged" impacts of a minimum wage increase on all hourly workers, focusing on those that were working for minimum wage, those whose wages were slightly above minimum wage as well as union and nonunion workers. Lagged impacts are those felt two to three years after a minimum wage increase.

The most startling finding of the report is that the largest negative effects of a minimum wage increase are felt by minimum wage workers. At the time of an increase, if a minimum wage worker is working part time, they are more likely to be laid off than someone working full time. As companies look for ways to mitigate the impacts of an increase in labor costs, they eliminate part-time positions. In addition to the immediate impacts, inflation rapidly catches up to the rate increase, eroding the purchasing power of minimum wage workers within a year or two after the increase. The line graph in Figure 1 details this. The purchasing power of minimum wage declines sharply after each increase.

For those workers that receive wages slightly higher than the new minimum wage, the results of this study show that a rate increase is equally detrimental to their economic well-being. Raises they receive that are the result of a rate hike are significantly smaller than the minimum wage increases. For example, a worker at a fast food restaurant earning $6.25 an hour will see little or no increase in his/her wages if a minimum wage increase occurs, unless minimum wage is raised above $6.25 an hour. Even if it is, a co-worker who was earning $5.15 an hour will see a larger gain in income than the employee earning $6.25. Additionally, the lagged impacts for these workers are often a significant reduction in hours. After companies eliminate part-time positions in an attempt to reduce labor costs, if that attempt is unsuccessful, the next step is to often reduce the number of hours remaining hourly workers are scheduled. This “trickle-up” effect then requires salaried employees to make up the difference. In the fast food restaurant example, this means that a shift manager or swing manager, often earning a salary equivalent to $7.00 to $9.00 an hour, is working longer hours. As a salaried employee, this manager is not eligible for over-time pay, thus longer hours effectively reduce that employee’s wage rate.

Finally, a surprising trend was revealed when researchers examined the impact of a minimum wage increase in states with high union representation. The impacts on union workers in the lowest-wage category are significantly different that those of non-union workers in the same wage category. Union workers see wage gains double that of non-union workers, suggesting that union contracts are written to adjust with any minimum wage increase. Union workers in the lowest wage category also see their hours worked increase as well as the possibility of overtime, while non-union workers are more likely to see their hours reduced. Finally, union workers in the lowest wage category are more likely to retain their jobs than non-union workers after a minimum wage increase, again suggesting that contract preclude lay-offs to reduce labor costs. The researchers also suggest there is evidence of “substitution” in favor of union workers after a rate increase, meaning that companies will eliminate low-skilled minimum wage non-union employees and replace them with union members that can perform more complex tasks. Bottom line, the researchers conclude, it is union workers with wage rates 1.2 to 1.5 times minimum wage ($6.18 to $7.73 an hour) that benefit the most from minimum wage rate increases.