

# Congressional Testimony on Minimum Wage

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## **Congressional Testimony on Minimum Wage**

On October 19, 1999, PPIC research fellow Joanne Spetz testified before the U.S. House Committee on Education and the Work Force on the minimum wage and its effects. Her co-authored study indicates that a 10 percent increase in minimum wages is associated with a 2 percent increase in welfare caseloads.

### **Summary of Testimony**

The minimum wage may have important effects on the likelihood of families needing welfare benefits. Minimum wages could help bring families out of poverty by increasing the incentive for individuals to work and raising their total earnings. However, if minimum wages reduce the demand for labor, then minimum wage increases may reduce employment opportunities for welfare recipients. In a recent study, Page, Spetz, and Millar (1999) use variation in minimum wages across states and over time to identify minimum wages' effect on the size of states' welfare caseloads. Using data for all fifty states from 1981 to 1996, the authors estimate models in which a state's welfare caseload is a function of the state's minimum wage and a variety of other factors. They find that an increase in the minimum wage of 10 percent is associated with an approximately 2 percent *increase* in welfare caseloads. This result suggests that minimum wages are not an efficient means of improving the financial independence of low-skilled adults, as the wage gains experienced by those who keep their jobs are counteracted by an increase in the welfare rolls.

### **Testimony**

#### **1. Introduction**

The degree to which minimum wages affect employment has interested economists and policymakers for decades. This interest has arisen largely from a potential inconsistency between the intent of minimum wage laws and their theoretical effects. The goal of minimum wages is to improve individuals' abilities to support their families and avoid welfare (see, for example, Ellwood, 1988), but the textbook model of supply and demand predicts that such wage gains come at the expense of lower employment levels (e.g., Baumol and Blinder, 1991).

The minimum wage may have important effects on the likelihood of families living in poverty or needing welfare. Most welfare participants live in

families headed by single mothers, and a substantial share of these women earn wages at or near the minimum wage. In 1996, about 14 percent of unmarried female household heads with children had wages that were between the 1996 federal minimum wage and the 1997 federal minimum wage.<sup>1</sup> Many other welfare recipients live in two-parent families with unemployed parents. Some research suggests that higher earnings encourage welfare recipients to work. Studies of the Earned Income Tax Credit indicate that wage increases positively affect single mothers' probabilities of employment (Dickert, Houser and Scholz, 1995; Eissa and Liebman, 1996).

However, if minimum wages substantially reduce the demand for labor, then minimum wage increases will have the opposite of their intended effect. Studies suggest that as many as one third of AFDC spells begin when a woman loses her job and up to one third of spells may end because of increases in earnings (Blank, 1989; Bane and Ellwood, 1983; Bane and Ellwood, 1994). Two recent papers (Hoynes, 1996 and Ziliak, Figlio, Davis, and Connolly, 1997) find that the probability of welfare participation increases when labor demand is low. Any labor market effects of minimum wage legislation are, therefore, likely to impact the size of the welfare caseload and the well-being of families.

## **2. Minimum Wages and Employment: A Review of Research**

A number of economists have studied the relationship between minimum wage increases and employment rates. Two things are striking about this literature. First, most researchers have focused on teenagers. Although teenagers make up a significant fraction of minimum wage workers, most teenagers do not live in poor families. Teenagers' employment decisions are undoubtedly affected by the fact that they are primarily supported by their parents, whereas single mothers' labor supply decisions may be influenced by the availability and affordability of child care. In addition, low-skilled adults may be more desirable workers than teenagers are because they have more work experience, are older, and are available for work over a wider range of hours. Thus, existing estimates of the relationship between minimum wages and teenage employment should not be used to predict how minimum wages will affect labor market outcomes and welfare participation among low-skilled adults.

The other notable feature of the minimum wage literature is the disagreement about whether minimum wages have any effect on employment. While many studies find that minimum wages reduce employment (Brown, Gilroy, and Kohen, 1982; Brown, Gilroy and Kohen, 1983; Brown, 1988; Wellington, 1991; Neumark and Wascher, 1992; Neumark and Wascher, 1994; Deere, Murphy and Welch, 1995; Kim and Taylor, 1995 Currie and Fallick, 1996), other research has brought these findings into question. Card (1992a, 1992b),

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<sup>1</sup> This number was calculated using data from the 1996 Current Population Survey Monthly Outgoing Rotation Groups. 13.7 percent of unmarried female household heads with children earned between \$4.25 and \$5.15 per hour. An additional 3.1 percent reported wages lower than the 1996 federal minimum wage of \$4.25.

Katz and Krueger (1992), Card and Krueger (1994), and Card, Katz and Krueger (1994) have found that minimum wages are associated with either no change in employment or even with increases in employment levels.

There are two reasons these studies find different effects of minimum wages on employment. First, researchers have examined data from different regions (cities, states, and nations) and time periods (short and long, and from various decades). It is possible that state-level minimum wage changes have different effects than federal minimum wage changes and that the minimum wage had a different effect on employment in the 1970s than in the 1990s. Burkhauser, Couch, and Glenn (1996) note that studies based on data from the 1980s find smaller negative effects of the minimum wage on employment than do studies based on data from earlier years.

Disagreement about the effect of minimum wages on employment also may arise from the different statistical methods and control variables used by researchers. Some statistical methods emphasize short-term relationships between minimum wages and employment, while others measure longer-term changes (Baker, Benjamin, and Stanger, 1999). In addition, there are many factors that affect employment levels, such as general economic trends, local wages, and demographics. As noted by Burkhauser, Couch, and Glenn (1996), research on minimum wages is sensitive to the choice of control variables. Some studies do a better job than others of controlling for confounding effects. For example, Kim and Taylor (1995) examine a minimum wage change first analyzed by Card (1992a), but Kim and Taylor add information on regional sales levels. The addition of this control variable changes the effect of the minimum wage on employment from positive to negative.

### **3. How Do Minimum Wages Affect the Poor?**

Until recently, researchers have examined whether minimum wages affect employment but have not studied the effects of minimum wages on poverty and welfare receipt. Thus far, it is not clear to what extent minimum wages improve the financial situation of families living in poverty. As noted by Burkhauser, Couch, and Glenn (1996), minimum wages are not very well targeted to families living in poverty. They find that only 30 percent of the wage gains from the 1989 federal minimum wage increase went to households at or below 150 percent of the poverty line, while households with incomes greater than 300 percent of the poverty line received 38 percent of the total wage increase.

Nonetheless, minimum wages could help bring families out of poverty by increasing the incentive for individuals to work and raising their total earnings. This is particularly true if minimum wages have negligible effects on the availability of jobs. Research on the degree to which minimum wages increase household earnings has produced mixed findings. Connolly and Segal (1997) find that poor and near-poor families experienced significantly higher growth in household earnings in states in which the 1990 and 1991 federal minimum wage increases should have had a greater impact. In contrast, Addison and

Blackburn (1996) do not find any statistically significant relationship between minimum wages and poverty. In a similar but more detailed study, Neumark and Wascher (1997) conclude that minimum wages effectively increase the incomes of some poor families, but that employment-reducing effects of minimum wages hurt other poor and non-poor families.

The costs of minimum wages must either reduce the profits of employers or be passed to consumers in the form of higher prices for goods and services. MaCurdy and O'Brien-Strain (1997) examine how these higher prices affect families. They find that low-income households pay a disproportionate share of these higher costs.

#### **4. Do Minimum Wages Affect Welfare Caseloads?**

In a recent study, Page, Spetz, and Millar (1999) use variation in minimum wages across states and over time to identify minimum wages' effect on the size of states' welfare caseloads. We analyze panel data for all fifty states from 1981 to 1996.<sup>2</sup> Because minimum wage levels vary across states and increase by different amounts in different years, these data allow us to compare differences in welfare caseloads across states and over time while controlling for both national time trends and static differences across states that might be correlated with both minimum wage levels and the size of the welfare caseload.

We use data from a variety of sources to control for factors that affect welfare receipt. We estimate models in which a state's welfare caseload is a function of the state's minimum wage, the average wage of production workers in the state, the state's unemployment rate, the state's population, the fraction of the population that is white, the fraction of households that are headed by females, gross state product, the combined value of AFDC and Food Stamp benefits for a family of three with no other income, and whether the state provides AFDC-Unemployed Parent (UP) benefits.

As noted above, estimates of the relationship between minimum wage levels and employment vary according to the statistical method used (Baker, Benjamin and Stanger, 1999; Neumark and Wascher, 1992). We estimate welfare caseloads using the two primary statistical methods used in minimum wage research. As in studies of the relationship between minimum wage legislation and teenage employment, our results are substantially different depending on the estimation strategy used. We then conduct specification tests that lead us to add more controls for state-specific trends to our model. After adding these additional controls, we get the same relationship between minimum wages and welfare caseloads using either of the two statistical methods; our estimates indicate that an increase in the minimum wage of 10 percent is associated with an approximately 2 percent *increase* in welfare caseloads. To put this estimate into perspective, our result suggests that in California, where minimum wages were recently increased from \$4.25 to \$5.75, we would expect welfare caseloads to

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<sup>2</sup> We were unable to include the District of Columbia in our analysis because we were unable to obtain a measure of production wages for the district.

increase by more than 7 percent, holding everything else constant. Of course, all else has not been held equal. Notably, implementation of PRWORA has changed the opportunities and incentives for many low-skilled workers.

A recent report by the Council of Economic Advisers (1999) reports a negative relationship between minimum wages and welfare caseloads. The CEA attributes 10 to 16 percent of the recent decline in welfare caseloads to increases in the minimum wage. There are two main differences between our model and the CEA analysis that account for the difference in our results. First, we examine different time periods. The CEA analyzes data from 1976 through 1998. This longer time period is problematic because few states had minimum wages that differed from the Federal minimum wage before the mid-1980s and there were major changes in AFDC in the early 1980s. Changes to the AFDC program may have led to reductions in AFDC caseloads and thus may confound the CEA analysis of the relationship between minimum wages and caseloads. In addition, the CEA does not control for as many differences between states as Page, Spetz, and Millar (1999). We test our model with numerous additional control variables, including controls for the Medicaid expansions of the late 1980s, changes in immigration, the existence of welfare waivers in some states, and political differences between states. We get a similar result in all these variations of our model.

## **5. Conclusions and Policy Implications**

Recent work by Page, Spetz, and Millar (1999) indicates that minimum wage levels are positively associated with the size of the AFDC caseload, and that, therefore, minimum wages will not help many low-income families achieve self-sufficiency. Our results suggest that a 10 percent increase in the minimum wage is associated with a 2 percent increase in welfare caseloads. These results suggest that minimum wages are not an efficient means of improving the financial independence of low-skilled adults, since the wage gains experienced by those who keep their jobs are counteracted by an increase in the welfare rolls.

Increases in minimum wages might lead to rising welfare caseloads for several reasons. First, as suggested by the classical economic model, the imposition of minimum wages can result in a reduction in the number of job vacancies. As jobs become less available, low-skill individuals are less able to find work and are thus more likely to apply for AFDC benefits. Second, increasing minimum wages might cause more workers to enter the labor market. If the new labor market entrants possess more human capital than likely welfare recipients do, then potential welfare recipients may be “crowded out” of jobs. Lang and Kahn (1998) found support for this possibility. In their study of minimum wages, they found that minimum wage increases shift food-service jobs from adults to teenagers and students. These younger workers might be considered more “able” than low-wage adults and thus displace adult minimum wage workers.

Either of these scenarios would result in lower employment levels among single mothers. Minimum wages may also lead to reductions in the number of

hours worked rather than total job loss, and it may be that the earnings decline resulting from a reduction in hours of work is large enough to make welfare participation more attractive.

The analysis of minimum wages and welfare described above demonstrates that increases in the minimum wage may impose a real cost on government – the cost of increasing welfare caseloads. Page, Spetz, and Millar (1999) estimate that the one-dollar increase in the minimum wage from \$5.15 to \$6.15 would increase welfare caseloads by over 130,000 families and cost state and federal governments up to \$1 billion a year. If one takes into account the fact that the increased production costs that result from minimum wages are at least partly borne by consumers (MaCurdy and O'Brien-Strain, 1997), then the cost to society of this policy will be much higher than the cost resulting from the increase in welfare payments. These indirect costs should be considered when comparing the cost of the minimum wage to the cost of policies with similar goals, such as the Earned Income Tax Credit. Policies like the Earned Income Tax Credit, which increases wages through the tax code without reducing the demand for low skill labor, are likely to encourage work and increase the earnings of low-income families more efficiently than raising the minimum wage (Burkhauser, Couch, and Glenn, 1996).

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