COMMUNICATIONS

The Economics of Minimum Wage Legislation Revisited

Richard V. Burkhauser and T. Aldrich Finegan

Introduction

In his seminal article "The Economics of Minimum Wage Legislation" (1946) George Stigler used what are now standard resource misallocation and loss of employment arguments to criticize the minimum wage. He wrote (1946: 358):

> The minimum wage provisions of the Fair Labor Standards Act of 1938 have been repealed by inflation. Many voices are now taking up the cry for a higher minimum. . . . The popular objective of minimum wage legislation—the elimination of extreme poverty—is not seriously debatable. The important questions are rather: (1) Does such legislation diminish poverty? (2) Are there efficient alternatives? . . . Some readers will probably know my answers already ("no" and "yes," respectively); it is distressing how often one can guess the answer given to an economic question merely by knowing who asks it.

Over four decades of empirical studies leave no doubt that increases in the minimum wage do reduce employment to some extent.[1] Yet by most counts, the number of lost jobs is trivial in the aggregate. Only for teenagers are statistically significant negative effects on employment consistently observed. Even for this group, we doubt

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[1]See Charles Brown, Curtis Gilroy, and Andrew Kohen (1982, 1983) and Brown (1988) for detailed reviews of this literature and Clifford Thies (1991) for a history of early minimum wage laws.

that the losses are large enough to end public support, although concern over teenage unemployment did play a role in the establishment of a sub-minimum wage in the 1989 Amendments to the Fair Labor Standards Act, which increased the minimum wage to $4.25 per hour in 1991. Rather, we believe that it is the latter part of Stigler's article—questioning the target efficiency of the minimum wage and advocating an alternative remedial policy—that will in the end persuade voters to abandon the minimum wage as a means of helping the working poor.

The Image of a Minimum Wage Worker

Franklin Roosevelt's 1937 impassioned speech calling on Congress to help the one-third of Americans who were "ill-housed, ill-clad, and ill-nourished" heralded in the Fair Labor Standards Act of 1938 and with it a national minimum wage. Echoes of that speech are still heard today. Senator Edward Kennedy (1989: S14707), in his criticism of the most recent increases in the minimum wage, declared:

> The minimum wage was, as it should be, a living wage, for working men and women. . .who are attempting to provide for their families, feed and clothe their children, heat their homes, [and] pay their mortgages. The cost-of-living inflation adjustment since 1981 would put the minimum wage at $4.79 today, instead of the $4.25 it will reach on April 1, 1991. That is a measure of how far we have failed the test of fairness to the working poor.

This New Deal image of low-wage workers struggling to earn a living wage for their families is as poignant today as it was in the 1930s. But Stigler claimed such an image overlooked the slippage between raising the hourly wage of low paid workers and lifting families out of poverty. He wrote, "Unless the minimum wage varies with the amount of employment, number of earners, non-wage income, family size, and many other factors, it will be an inept device for combatting poverty even for those who succeed in retaining employment" (1946: 363). Unfortunately, Stigler had no national data with which to confirm his doubts on this score.

Here we provide an empirical confirmation of Stigler's original position and see how well his views have withstood the test of time. We look at the bottom half of the United States wage distribution and see how well workers' positions in this distribution match the economic well-being of their families.

Data

Our data come from the 1 percent samples of the 1940 and 1950 census, the 1/1,000 samples of the 1960, 1970, and 1980 censuses, and the March 1988 *Current Population Survey* (CPS). Our measure of average hourly earnings in the year preceding each census or survey was obtained by dividing the respondent's reported wage or salary income that year by the product of estimated usual weekly hours worked that year times estimated weeks worked that year.[2] We limited our study to 17-to-64 year old wage and salary workers who worked at least 14 weeks in the preceding year and at least 15 hours in the census or survey week.

Our measure of family economic well-being is the family's income-to-needs ratio. This is the ratio of total family income to official Bureau of the Census poverty line for a family of its size. Values of the poverty line for different years were adjusted for changes in the consumer price index. Unfortunately, the 1940 Census did not ask respondents how much income they received from sources other than wages or salaries in 1939. Therefore our measure of family well-being for that year is the ratio of the family's wage or salary *earnings* to its poverty level.

The Link between Wages and Family Income

Table 1 summarizes our findings. Here we present a matrix of coefficients of determination R^2 between the hourly earnings of workers in the bottom half of the wage distribution and the income-to-needs ratio of the households in which they reside.[3] These lower paid workers are classified by family status. In 1939, about one-fifth of the interpersonal variance in the household wage and salary incomes of all these workers was associated with differences in their wage rates, i.e., the R^2 is .207. Not surprisingly, this association was much stronger that year for unrelated individuals (.677) than for heads of families (.241), and was weakest for other family members (.204)—a pattern repeated each year. The much weaker association for workers in families reflects the importance of interfamily differences in number of earners and family size, as Stigler foresaw. Whereas the case for the minimum wage has always rested on the need to help families with low-wage heads, by far the strongest link between low wages and poverty is found among the small minority of workers who live alone.

Whether or not one considers an overall R^2 of .207 as evidence that, in Stigler's words, "the connection between hourly wages and

[2] A detailed summary of estimation procedures and data problems is presented in an Appendix, which will be sent to interested readers upon request.

[3] The median wage provides an upper bound on the range of workers who could conceivably directly benefit from a minimum wage.

TABLE 1

VALUES OF R^2 BETWEEN HOURLY WAGES AND FAMILY INCOME-TO-NEEDS RATIOS FOR WORKERS EARNING LESS THAN THE MEDIAN WAGE: 1939–87[a]

Year	Median Wage	Values of R^2 for: All Workers	Heads of Families	Other Family Members	Unrelated Individuals
1939[b]	$0.48	.207	.241	.204	.667
1949[c]	1.45	NA	.188	NA	.573
1959	2.05	.130	.174	.191	.547
1969	3.12	.078	.144	.106	.534
1979	5.84	.046	.114	.062	.552
1987	8.65	.050	.137	.056	.382

[a]Workers in the bottom 1 percent of the wage distribution were dropped each year. All correlation coefficients are positive and significant at the .99 level.

[b]Income-to-needs ratios in 1939 exclude income from sources other than wages and salaries (see text).

[c]Owing to unusual sampling procedures in the 1950 Census, data for all workers and other family members are not available for 1949.

SOURCE: 1 percent samples of the 1940 and 1950 census; 1/1,000 sample of the 1960, 1970, and 1980 census; March 1988 *Current Population Survey*.

the standard of living of a family is remote and fuzzy" (1946: 363) is debatable. But time has been on Stigler's side. Since 1939 the connection between below median wages and family income has weakened dramatically. By 1979, the coefficient of determination had fallen to .046 for all workers, .114 for family heads, and .062 for other family members. Much of the downtrend is due to the spread of multiple earner families. Only for unrelated individuals does the tie between lower pay and lesser well-being remain strong. Data from the March 1988 CPS tell a very similar story.[4]

An Old Public Policy Lesson for a New Day

In the 1930s, social reformers advocated a minimum wage to ensure that the families of those who worked would receive a living wage.[5] In the absence of a federal safety net to provide income more directly to those judged to be in extreme poverty, it could be argued that this indirect method of targeting the poor may have been acceptable policy. Today, like-minded reformers are disappointed with the current federal safety net. The accumulation of large budget deficits and a public opposed to higher taxes have made such reformers look once again to private-sector mandates as a means of ameliorating poverty.

Table 1 should, we think, give pause to those who still hold a 1930s' view of poverty relief. Save for unrelated individuals, the link between how much a worker earns per hour and the economic well-being of his or her household is now almost completely lost —and, along with it, the target efficiency of minimum wage legislation. But the severing of this link has implications beyond minimum wage policy. In order to insure tax exemption status for their fringe benefit packages, firms are required to provide them "equitably" across the wage distribution of their employees. Our table suggests that in a world of multiworker families, such regulations may provide far less income to low income households than meets the eye. This same point can be raised with respect to attempts to mandate mandatory

[4]For evidence that the economic well-being of the families of minimum wage workers improved greatly from 1949 to 1979 and a simulation of how the benefits from the most recent increase in the minimum wage were distributed, see Burkhauser and Finegan (1989).

[5]Thies (1991) traces the history of minimum wage policy back to the period of individual state-initiated minimum wage legislation in the early twentieth century and argues that Father John A. Ryan's book *A Living Wage* (1909), popularized the view that "employers were normally obligated to pay workers a living wage, and [Ryan] advocated state coercion of the same through laws providing for minimum wages. . ." (Thies 1991: 720).

minimum health or pensions for all workers. Supporters of such mandates almost always assume that low-wage workers live in low income households.

The Earned Income Tax Credit

A superior alternative to these employer-mandated strategies of redistributing income to the poor is the Earned Income Tax Credit (EITC). In 1992, this program provided a tax credit of 17.6 cents per dollar of the first $7,520 of wage earning in a poor family with one child and 18.4 cents per dollar on the same amount for a family with more than one child. Benefits are phased out at a rate of 12.57 (13.14) cents per dollar above $11,840 for a one (two or more) child family and all benefits are lost at an income level of $22,370. This grandchild of the negative income tax advocated by Stigler in 1946 is far more target efficient than a minimum wage.[6] In addition, unlike the minimum wage which reduces the demand for low skill labor, the EITC has no adverse affects on the demand for such workers.[7] In 1993 the Clinton Administration, with bi-partisan Congressional support, greatly expanded the Earned Income Tax Credit so that by 1996 it will provide a tax credit of 34 cents per dollar on the first $7,520 of wage earning in a poor family with one child and 36 cents per dollar for such a family with more than one child. But in the same year the Clinton Administration also called for a $0.25 increase in the minmum wage.

[6]The target efficiency of a negative income tax has long been recognized by economists. Christopher Green (1967) believes the two main proponents of this form of distribution to the poor in the 1960s were Milton Friedman [see Friedman (1962)], and Robert J. Lampman [see Lampman (1965)], but that its origins go back to the 1940s. According to Green, "correspondence with Friedman, Walter Heller, William Vickrey, and Louis Shere turned up the fact that there had been some discussion of [a negative income tax] during the 1940s, and that the subject had been informally discussed by some researchers, including Heller and Vickrey, then at the Division of Tax Research, Treasury Department. There is no evidence, however, that a paper on the subject was prepared in the Division of Tax Research" (Green 1967: 57, n. 21). He then cites the Stigler (1946) article as evidence that the idea was in the air in the 1940s. Stigler, in personal correspondence with the authors, reported that "for some reason that I cannot recall but have long regretted, I omitted from my passing endorsement of the negative income tax the appropriate footnote, 'I'm indebted to Milton Friedman for this suggestion.' "

[7]Burkhauser (1992) and Burkhauser (1993) advocate extension of the Earned Income Tax Credit as the least disruptive means of increasing the income and employment of workers with disabilities who live in poor families. The EITC is argued to be a far superior mechanism than the Americans with Disabilities Act of 1990 of assisting the "doubly disabled"—those who have both poor work skills and health impairments.

Here we have provided some evidence to support Stigler's view that the connection between wages and family income was remote and fuzzy even in 1946. We provide stronger evidence that the views of Nobel Prize winners tend to be ahead of their time.

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Checking Out the House

Jim F. Couch and William H. Wells

The Traditional Explanation for Excessive Government

Citizens interested in responsible federal spending have been sorely disappointed with recent results. An explosion of federal expenditures has occurred in this century. As reported in the *Economic Report of the President* (1993), total federal government expenditures in 1992 as a percentage of GDP was 23.5 while only 10.8 percent of GDP in 1934.

Economists offer several explanations for the growth of government spending. Spending can stimulate the economy in the short run by increasing output and lowering unemployment. Politicians that hope to be reelected are encouraged to take a short-run view since it is in their interest to see that the economy performs well today (Nordhaus 1975). Stimulative fiscal policy can help ensure that outcome. Spending is also attractive to members of Congress because they are elected from a particular geographic region rather than at large. These elected representatives receive a higher political payoff from promoting the local interests of their constituents than they do from taking positions in support of the so-called public interest. Therefore legislators have a strong incentive to search for public policies and programs that confer direct benefits on their home districts while imposing costs on taxpayers in general, most of whom reside, and vote, in other jurisdictions. Incumbent politicians are able to use such techniques to enhance their prospects for reelection. The fact that challengers rarely win congressional elections along with the idea that "career politicians" are largely responsible for the

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