

About the minimum

There are better ways A disincentive to work

By SOLOMON W. POLACHEK and STANLEY MASTERS

For the economy and for the social welfare of the nation it is important that each person be able to find a job and earn a decent wage. One way to try to achieve this goal is to legislate a wage floor, a minimum wage, which employers must pay.

Whether such government regulation is good policy continues to be hotly debated. Until recently, most economists have argued that it is not. Increasing the minimum wage reduces the number of workers that employers seek to hire. At the same time, increasing the minimum wage probably induces additional people to look for work. With more people seeking work and fewer jobs available, unemployment would rise. Those hardest hit would be those with the fewest skills, especially teenagers and young adults with little schooling.

Effect on the young

A large body of econometric work attempts to assess how much effect minimum wage legislation has had on employment. Since a much higher proportion of teenagers than adults are paid the minimum wage, much of the literature concentrates on the employment effects of young people. Holding other factors constant, analysts seek to determine how changes over time in the price-adjusted value of the minimum wage affect the employment of teen-agers. The most widely held view is that a 10 percent increase in the minimum wage in the United States reduces the employment of teenagers by about 1 percent. If this estimate is correct, a 20 percent increase (from \$4.25 to \$5.15) as is now proposed would decrease teen-age employment by about 100,000.



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Recently two prominent economists at Princeton University, David Card and Alan Krueger, have done a series of studies looking at the effects of interstate variation in changes in the minimum wage. For example, one of their studies contrasted teen-age employment in New Jersey and Pennsylvania at fast food restaurants. In 1992, New Jersey increased its minimum wage to \$5.05 while Pennsylvania kept its at \$4.25. (Each state can have its own minimum wage exceeding the federal standard, and many do.) Their analysis revealed that, subsequent to the rise in New Jersey's minimum wage, employment in its fast food restaurants experienced no decline relative to employment in similar Pennsylvania restaurants and may even have increased slightly. They found similar results for teen-agers when California increased its minimum wage in 1988 and for low-wage workers in states most affected by the increase in the federal minimum wage to \$4.25 in 1991.

in the minimum wage to help achieve the widely-accepted goal of helping workers achieve a decent wage. Unfortunately the issue is not this simple. If we make the rather extreme assumptions that 1) employers make no adjustments to an increase in the minimum

Minimal Impact

As a result of the work by Card and

Kreuger, there has been renewed debate among labor economists about whether small increases in the minimum wage reduce employment. Nevertheless, there is widespread agreement that the magnitude of any employment effects is likely to be very small. If so, then it might seem obvious that we should favor an increase

By GREGG EASTERBROOK Times-Post News Service

More than anything else, the "chump change" calculation bedevils welfare policy. Namely: Being on public assistance is sometimes a better deal than work. If you give up welfare to labor 40 hours at the minimum wage, you may end up worse

Politics muddies the picture, page 4E

welfare structure. But it is not. Rather, it is a phenomenon of the eroding value of the minimum wage. This aspect of wage policy has been entirely overlooked in reaction to President Clinton's proposal to raise the federal minimum to \$5.15 an hour. Raising the minimum wage is not just a means to promote fair pay. It is a means to get people working by abolishing chump change.

Declining value

In the 1960s, the minimum wage was worth about \$6.40 an hour in 1994 dollars, vs. the current minimum wage of \$4.25 an hour. That meant that in the 1960s, if you left the dole to work 40 hours at minimum wage you came out ahead — even after paying taxes. Beginning in the late 1960s, Congress let the minimum wage decline relative to inflation. During the same period, public assistance benefits began to rise.

Sometime in the 1970s, the lines crossed: Starting work became less rewarding than drawing the government check. In the past two decades, as increases in the federal minimum wage consistently lagged behind inflation, for those eligible for welfare, in most states, entry-level labor has grown less appealing economically than idleness. This can be the case even when the newly expanded Earned Income Tax Credit, special payments that assist the working poor, is taken into account.

Work, being hard, is supposed to offer rewards, including money. All but chronic welfare recipients generally wish to work, if rewarded. "Studies are very clear," says Rebecca M. Blank, an economist at Northwestern University, "that anything that makes work more attractive improves the likelihood people will get off AFDC (Aid to Families with Dependent Children)." But in the current minimum-wage regime, some work penalizes welfare recipients rather than reward them.

Link to welfare

Discussion of the link between entry-level pay and welfare dependency has been absent from debate of the minimum wage, to ensure, in Clinton's words, that "work must pay." Many of the same politicians and pundits who pronounce themselves (with considerable justification) horrified by the welfare culture nonetheless oppose federal wage policy — not seeming to realize how the two feed off each other.

Some opponents claim a higher minimum wage will depress the economy, although even at \$5.15, the minimum wage would be lower in real terms than during the 1960s — a period enshrined in political nostalgia as a time of economic boom. Some — among them new House Majority Leader Richard Arroyo of Texas — say raising the minimum wage will reduce jobs, although a recent study by David Card and Alan Krueger, two Princeton University economists, undercuts this idea.

Card and Krueger found that total jobs often rise as the minimum wage rises: For most companies, general economic condi-

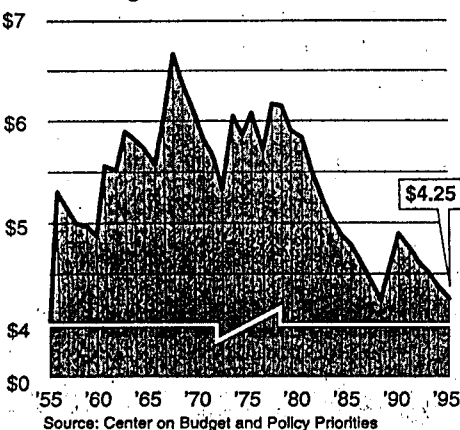
Battle over minimum wage heats up

Democrats say the minimum wage should be raised. Republicans argue the increase will cost jobs. Here are statistics that argue for (left) and against the proposal.

1. Minimum's declining value

The value of the minimum wage today is only a penny above the historic low of 1989 when the wage was increased by 90 cents.

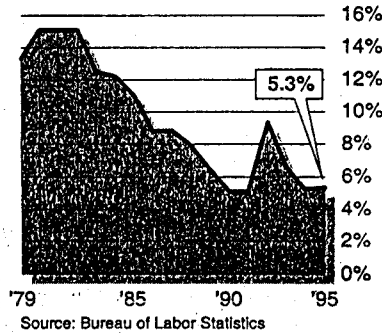
Minimum wage value in constant 1996 dollars



2. Fewer working at bottom wage

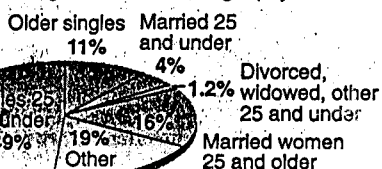
While the value of the minimum wage has been declining over the years, the percentage of workers taking home that wage or less has declined by well over half.

Percent of hourly workers paid the minimum or less



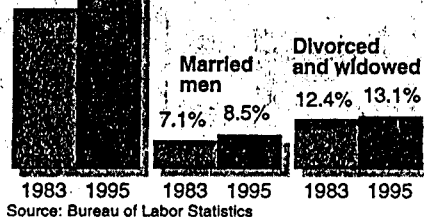
4. Majority still young, single

Still, most minimum-wage workers are under 25 or single or are married women, whose husbands most likely bring home another, larger paycheck.



3. And the kinds of workers are changing

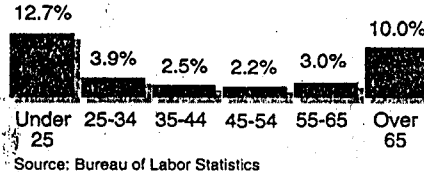
While the number of workers earning the minimum wage has been shrinking, the composition of the workers has changed — more workers are older than 25 and more are married men or divorced.



5. A bulge of older workers

Most minimum-wage workers are young, but a significant number of older workers return to those low-skill jobs to supplement their retirement.

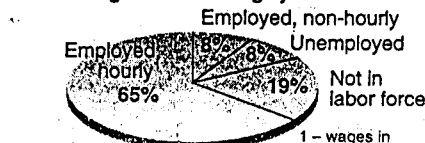
Percent of workers earning minimum wage



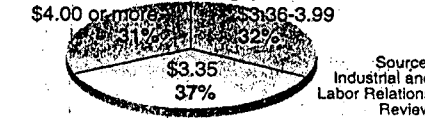
6. Minimum, short-term wage

The minimum wage is a short-term pay rate. Within a year, most minimum-wage workers will have received raises or be working for salaries.

Employment status one year after taking minimum wage job



Hourly wage one year later (\$3.35 was minimum wage)



GNS

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Easterbrook is a contributing editor to Newsweek and the Atlantic Monthly.

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...my worse.
 To a liberal Democratic labor leader the proposal really does not have a political purpose, although a lot of politics will be involved, and its economics is essentially a matter of social justice. The opposing argument about a free market is seen as simply not recognizing that, given the unequal market power of labor and management, a classic free labor market does not exist.

Complex process
 Obviously, these two perspectives look right past each other, and the political system must be used to arrive at a resolution. The poli-

tions of American occupations can produce uncertain results. For example, there are managers and then there are managers. The manager of a McDonald's restaurant is likely to have a different view of the minimum wage from the manager of a cooperative farm or the manager of a low level drug ring. And when the McDonald's manager is black, that person probably faces a dilemma between his new position and his old-time party loyalty. Nevertheless, these occupational complexities seem relatively

vote, the Republicans want to avoid the issue.
 Which brings us to our current political situation, affected by all of the preceding, plus the resignation of Republican Bob Dole, Senate Majority Leader, who is running for president. While Dole is still in office, Senate Democrats have been repeatedly attempting to bring the issue to a vote, some even being willing to attach it to various other issues — such as cutting the gasoline tax — that Republicans would like. Naturally, Dole's strategy is to prevent the issue from coming to a vote, or to load it with amendments unacceptable to Pres-

very unlikely that the proposed increase will be brought to a vote, and if it is, who knows what baggage it will be carrying. And then there is Newt Gingrich's House of Representatives, far less willing to bargain than the Senate! Until a few days ago, GOP hard-liners in the House were trying to kill the minimum wage by proposing alternatives, such as removing the withholding tax from low-income workers, thus raising their take-home pay.

Still, we have now seen that once the House leadership decides to act, they can do so in a hurry. Recognizing public opinion, they have accepted the narrow defeat of a limiting amendment, and the House has passed an almost clean bill. Of course whatever comes out of the House will have to be resolved with what the Senate does — another struggle, with more pressure on Dole.

steaming themselves in lime and carbolic acid.
 The only thing Americans knew about for sure was the result of the disease, described here in the Oregon Trail diaries of Rachel Fisher Mills in 1848 and John Clark in 1852.
 Mills wrote: "Little Angeline was more dear to me than anything ever had been ... She appeared well and playful and ate her dinner about as usual. Soon after dinner she became feverish which increased very rapidly, her lameness became very painful, getting worse through the night, and the following morning she commenced having fits and died about noon."
 Clark wrote of a scene along the Platte River in Nebraska: "One woman and two men lay dead on the grass and some more ready to

Other ways to help wage-earners —

Continued from Page 1E

wage and 2) increases in the minimum wage have no effect on worker productivity, then those earning the minimum wage gain when it is increased, but their employers lose. While low-wage workers are deserving of our support, so are the hard-working small-business people who employ many minimum-wage workers. Given the potential redistribution of earnings between these two groups as a result of changes in the minimum wage, it is not surprising that minimum-wage legislation continues to be a highly controversial political issue.

Small increase, little impact
 Although the minimum wage continues to receive considerable debate, the empirical evidence strongly suggests that small increases in the minimum wage, such as the proposed increase from \$4.25 to \$5.15, are unlikely to have large effects on any aggregate measure of our economic performance. For example, Card and Krueger not only find no empirical evidence of negative employment effects, they also find that past increases in the minimum wage have had very modest effects on the profits of low-wage employers and on the earnings inequality of states that have increased their minimum wage rates.

On the other hand, if the minimum wage were to be increased substantially, say to \$20 per hour, then we believe there would be significant effects, not only on earn-

ings, but also on employment and profits.

Other strategies
 If small increases in the legal minimum wage are not likely to have much effect and if large increases are not only politically unfeasible but also likely to have adverse side effects, then are there more promising approaches to increasing the job opportunities and income of low-wage workers? We believe there are several. In the space remaining, we discuss three such alternatives: providing a subsidy for low-wage earners, improving our educational system, and maintaining high aggregate demand for labor.

First consider the Earned Income Tax Credit (EITC), which provides a refundable tax subsidy to low-income families. For a family with two children, the EITC provides a subsidy of \$35 for every \$100 the family earns, until annual earnings reach \$8,600. For earnings of \$8,600 to \$11,300, the annual subsidy is \$3,110. At higher earnings, the subsidy declines by \$20 for each \$100 additional earnings until it ends for those earning more than \$27,000. This EITC provides a subsidy to families with low earnings, paid for by taxpayers. In contrast, the minimum wage can be viewed as a subsidy by employers to those who otherwise would be earning less than the minimum wage — regardless of whether another family member has high earnings. In our view, increasing the Earned Income Tax Credit is more equitable than increasing the minimum wage.

Focus on education

To increase the earnings of those with low-wages, the best approach is for such workers, especially young workers, to increase their productivity by attaining more and better schooling. For example, it is estimated that 25 million Americans — most of whom are native-born whites — cannot read the poison warnings on a can of pesticide, a letter from their child's teacher, or the front page of this newspaper. Although we do not know how to change our schools to help establish a more highly skilled, literate work force, we are confident that job opportunities and relative wage rates will continue to decline for those who cannot read and write effectively.

Demand for labor

We also need a strong aggregate demand for labor in our economy. In many areas of the country, a high demand for labor pushes up wage rates for all workers above the minimum wage. We know how to use monetary and fiscal policies to increase aggregate demand, but we don't know how to do so without increasing inflation. In the long run, inflation is very costly to the economy since it increases uncertainty, thereby decreasing productivity and price-adjusted earnings of most workers. Although concern for inflation limits how much we can increase aggregate demand, to help low-wage workers it is crucial that demand be kept as high as possible without contributing to unacceptable levels of inflation.

Low minimum has ripple effect —

Continued from Page 1E

ions — including the buying power of consumers — seems more important than additions to the hourly wage base. And though some opponents say increases in the federal wage mainly helps teenagers doing after-school jobs, statistics show about 60 percent of those earning minimum wage are parents supporting families.

A disincentive
 Conservative writing on the cycle of welfare often hits on the point that federal taxes on entry-level wages create a disincentive to work, but ignores the disincentives created by the falling value of the minimum wage. For example Charles Murray's *Losing Ground*, the Torah of the conservative anti-welfare movement, details the anti-work impact of taxes on entry-level labor, because the right hates taxes, but skips over the question of the falling minimum wage, because the right want wages low (but salaries high, if you get that distinction).

Raising the minimum wage would, of course, be no panacea for welfare. Sheldon Danziger, a professor of social work at the University of Michigan, estimates that perhaps a fifth of welfare recipients now deliberately avoid jobs owing to the chump-change factor. Perhaps half that group might be enticed to work by a more reasonable minimum wage, roughly suggesting a best-case result of a 10 percent reduction in welfare rolls. Sound insignificant? Clinton's fiscal 1996 budget proposal contains \$223 billion in social welfare spending. A 10 percent reduction from

such a figure would represent a fantastic savings — enough to fund serious welfare initiatives for most of the rest of the chronically unemployed.

Sideways health reform
 In a sense, raising the minimum wage might achieve for the poor something the collapsed Clinton health-care reform failed to achieve. "For welfare recipients, especially mothers, losing health-care benefits is by far the greatest barrier to going to work," Danziger says.

In most states, if you're on the dole, Medicaid is free. Get a job and your Medicaid eligibility expires — and chances are your employer provides no health insurance. Danziger notes, "An unreported aspect of the Clinton health-care reform was that by guaranteeing care to everyone, it would have ended the leading crazy disincentive that now prevents welfare recipients from working. But since the president couldn't get health reform, a higher minimum wage may be the next best thing in terms of making work attractive."

Yes, the cost of lobster "fajitas" in yuppie restaurants, and Life-Sized Barbies at the Toys 'R' Us, would rise slightly. But if affluent voters and politicians won't make such small sacrifices in order to fund policies that reward free-market work, just what sacrifice will they make?

Because most welfare recipients are women, some analysts see a higher minimum wage as a woman's benefit bill — perhaps a reason for the lack of conservative


enthusiasm. Yet properly construed, the initiative should be seen as beneficial to men. "Raising the minimum wage would be pro-family because it would make poor men more attractive husbands economically," says Jared Bernstein, an economist at the Economic Policy Institute, a Washington think tank.


Infuriating as it is, Murray's *Losing Ground* contains many haunting insights, among them how, to women in the welfare culture, a "child provides the economic insurance that a husband used to represent." Today, at the minimum wage, an unskilled man who wants to work and marry offers a prospective wife less than the government offers via the dole. If the minimum wage were raised that would change.


Effect on families

The decline in two-parent families in the United States since the 1960s is commonly ascribed to perverse welfare policy that rewards living out of wedlock. But how about the declining minimum wage, which leaves the entry-level working man in the humiliating position of bringing into the house less money than the baby's welfare check?

The past two decades of eroding rewards for hourly work seem tailor-made to discourage men from taking responsibility for children. If the right cares, as it claims to, about reversing the "fatherless America" effect, higher minimum wages would be a good place to start.

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