Federal Minimum Wage Increased

BY VANESSA SUMO

Included in the bill providing funding for the Iraq War that President Bush signed into law in May is a provision to raise the federal minimum wage, the first legislated increase in a decade. The wage floor will go up by $2.10 an hour, in three stages, to $7.25 over the next two years. Tax breaks were also part of the provision, ostensibly to offset some of the additional costs that will be borne by small-business owners, who fought hard against an increase.

Proponents say that raising the minimum wage is long overdue. (Many states have moved to raise the state minimum wage ahead of this legislated federal increase. In the Fifth District, only South Carolina doesn't have a state minimum wage law.) Due to inflation, the $5.15 an hour that minimum wage workers earned prior to the change bought about 23 percent less than when lawmakers last raised the rate in September 1997. Moreover, a full-time minimum wage worker took home about 38 percent less than the poverty income level for a family of three, according to the Economic Policy Institute, a liberal-leaning think tank. Thus, it would appear that raising the minimum would be of great help to this particular group.

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But that assumes everyone gets to keep his job. In a competitive labor market, wage levels adjust until the amount of labor demanded by firms equals the amount supplied by workers. Legislating an effective wage floor prices some workers out of the market, because employers are unwilling to pay them the minimum wage given those workers' skill sets. So, those who are able to acquire or retain their jobs are made better off, but those who are kept out of the labor market are made worse off. In short, according to standard economic theory, increasing the minimum wage causes more low-wage workers to become unemployed, typically the least skilled and least experienced, hurting some of the very people that lawmakers were trying to help. Of course, in response to a minimum wage increase, companies could act to reduce other components of their labor costs (fringe benefits, hours worked, etc.) to keep their total expenses unchanged. But if other forms of compensation are reduced, it is unclear how employees are affected on balance.

Finding a mainstream economist who supports a hike in the minimum wage used to be like finding a rare bird. However, a few studies in the 1990s prompted a reassessment. For example, empirical research at the state level by economists David Card of the University of California at Berkeley and Alan Krueger of Princeton University found a small but positive employment effect from raising the minimum wage. Many economists remain skeptical of Card and Krueger's findings, but some have conceded that the negative effect on employment could be more modest than once thought.

In part, this is because a relatively small share of overall workers receive the minimum wage. Most earn wages well above the minimum, and thus are neither directly helped nor harmed by a change. As Charles Brown, an economist at the University of Michigan, has written: "It is hard for me to see evidence that minimum wage increases have benefits which would overcome an economist's aversion to interfering with reasonably competitive markets. But the case against the minimum wage seems to me to rest more upon that aversion than on the demonstrated severity of any harm done to those directly affected."

The objective of a binding minimum wage is to give low-income earners a boost, but this is arguably not the only way to accomplish the same goal. In fact, setting a wage floor is often compared with the Earned Income Tax Credit (EITC) program, which reduces payroll taxes paid by low-income families.

The EITC has been praised by most quarters because the way it is designed provides an incentive for people to work more. The amount of credit that families are entitled to increases as their income from working increases. This credit plateaus and then slowly declines as their income rises further, presumably so as not to completely offset the incentive to work. Some studies show that the EITC has had a positive effect on the supply of labor, especially along the "extensive" rather than the "intensive" margin. That is, the EITC has encouraged those previously unemployed to enter the labor force, particularly single mothers, rather than stimulating workers to put in more hours.

Thus, by raising employment the EITC seems to address what was primarily the problem with the minimum wage program. Moreover, in comparing the effect of both policies on family income, economists David Neumark of the University of California-Irvine and William Wascher of the Federal Reserve Board of Governors find that "the EITC has been more beneficial for poor families than is the minimum wage." Nonetheless, the Economic Policy Institute maintains that *both* programs are needed, that "the EITC and minimum wage work in tandem to raise a family's income." **RF**