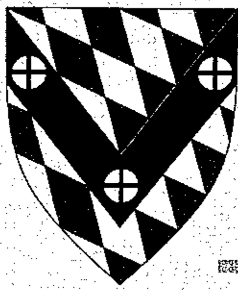

ECONOMIC DIRECTIONS

CENTER FOR ECONOMIC AND POLICY EDUCATION, SAINT VINCENT COLLEGE, LATROBE, PENNSYLVANIA VOLUME 6 NUMBER 1 NOVEMBER 1995

PROVIDING A LIVING WAGE: WHY INCREASES IN THE MINIMUM WAGE ARE NO LONGER THE ANSWER FOR HELPING THE WORKING POOR

(The following is a lecture delivered by Dr. Richard V. Burkhauser, a Professor of Economics at the Maxwell School of Syracuse University, at Saint Vincent College, Latrobe, Pennsylvania, on October 4, 1995 as the 30th lecturer in the Center for Economic and Policy Education's Alex G. McKenna Economic Education Series. Professor Burkhauser, C'67, is a graduate of Saint Vincent College.)

A Historical View of Minimum Wage Policy

In the introduction of his seminal 1946 *American Economic Review* article which established how the debate on the minimum wage would be waged over the next half century, George Stigler, a Nobel Prize winning economist and one of my teachers at the University of Chicago, said:

> The minimum wage provisions of the Fair Labor Standards Act of 1938 have been repealed by inflation.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.... Economists have not been very outspoken on this type of legislation. It is my fundamental thesis that they can and should be outspoken, and singularly agreed. 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? The answers are, if I am not mistaken, unusually definite for questions of economic policy. If this

> is so, these answers should be given. 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. But my personal answers are [not as] important [as] the arguments on which they rest (Stigler 1946, 358).

Let me remind you that 1946 was the first year a Republican majority was elected in both the United States House of Representatives and the Senate since 1930. In that same year a first term Democratic president committed to the preservation of New Deal policies was considered a sure bet to be defeated in the next presidential election by a Republican challenger to those principles. At that time, and for many people even today, no program provided a stronger litmus test of loyalty to traditional New Deal principles than the minimum wage. Stigler's arguments against it were carefully chosen to criticize the minimum wage both on what are now familiar efficiency grounds and more surprising, at least in 1946, on its ability to effectively reduce poverty.

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Since 1946, critics of minimum wage increases have stressed its labor market inefficiencies, and most of the empirical literature on minimum wage policy has concentrated on the perceived negative employment effects of increases in the minimum wage. But I am convinced that it is with respect to the second issue raised in the Stigler article—how one should evaluate "who gets what" from an increase in the minimum wage—that most Americans are concerned, and it is here that the minimum wage now is seen as hopelessly out-of-date.

In his 1946 article, Stigler argued that:

> The connection between hourly wages and the standard of living of a family is remote and fuzzy. 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 combating poverty even for those who succeed in retaining employment (Stigler 1946, 363).

It is not an accident that Stigler emphasized the concept of poverty elimination in his article. He was influenced by nearly half a century of debate surrounding the creation of a living wage which was intended by its proponents to insure a minimum standard of living for workers and their families in the United States.

One of the earliest and most comprehensive proposals for a government enforced minimum wage was made in 1906 in the book *A Living Wage* by Father John A. Ryan, a Roman Catholic priest, who argued that "Whole classes of laborers, for example those employed in sweat shops, are underpaid, underfed and undersupplied with everything which contributes to civilized life" (Ryan 1906, 18). This important book, whose introduction was penned by the founder of the University of Wisconsin economics department and the first president of the American Economic Association, Richard Ely, helped popularize a living wage as a social goal. The concept of a living wage was based on the ideas of a broad spectrum of social reformers of the day, from Pope Leo XIII, who argued in *Rerum Novarum* (1891) that "There is a dictate of nature more imperious and more ancient than any bargain between man and man, that the remuneration must be enough to support the wage earner in *reasonable and frugal comfort"* [Ryan emphasizes] (as quoted in Ryan 1906, 33), to Sidney and Beatrice Webb, who in *Industrial Democracy* (1897) called for state enforced national minimum wages that would provide laborers "with the food, clothing and shelter physiologically necessary, according to national habit and custom, to prevent bodily deterioration" (as quoted in Ryan 1906, 82).

Proponents envisioned that the minimum wage would be "determined and secured through a commission, empowered to adjust it to different industries and different centers of population" (Ryan 1906, 315). They saw this type of governmental regulation as the best possible antidote to "that perverse individualism which prefers irrational liberty and industrial anarchy to a legal regime of order and justice" (Ryan 1906, 313). The minimum wage was only one of a set of social goals articulated in Ryan's book—which included the eight-hour day, the end of child labor, and social security—that social reformers sought to obtain through direct government intervention in the marketplace.

The crusade for the establishment of a living wage through legislation spans the entire twentieth century. Continued support for the minimum wage today is based in part on important legal and political precedents its establishment created for further government intervention in the marketplace in the name of social justice.

> *"Today, the appropriate question to ask is what alternatives to minimum wage hikes are available to help insure a living wage for the working poor."*

Resistance to the minimum wage first centered over its constitutionality. The nineteenth century view that the right to contract was part of the liberty protected by the 14th Amendment to the Constitution and that the right to purchase or sell labor could only be abrogated by legislatures on very narrow grounds received perhaps its strongest judicial endorsement in *Lochner v. New York* (198 U.S. 45, 1905). In that case the United States Supreme Court nullified by a five-to-four vote a New York State law establishing maximum hours of work. In his solitary minority opinion, which first urged a "reasonable man" test on restrictions of liberty, Justice Oliver Wendell Holmes stated:

> A constitution is not intended to embody a particular economic theory, whether of paternalism and the organic relation of a citizen to the state or of laissez-faire. It is made for people of fundamentally different views, and the accident of our finding certain opinions natural and familiar or novel and even shocking ought not to conclude our judgment upon the question whether statutes embodying them conflict with the Constitution of the United States...I think the word liberty in the 14th Amendment is perverted when it is held to prevent the natural outcome of a dominant opinion, unless it can be said that a rational and fair man necessarily would admit the statute proposed would infringe fundamental principles as they have been understood by the tradition of our people and our law (*Lochner v. New York*, p.76).

WELCOME BACK - Welcoming Dr. Richard V. Burkhauser, C'67, (fourth from left) back to Saint Vincent were, from left, Dr. Gary M. Quinlivan, executive director of the Center for Economic and Policy Education; Dr. W. Richard Houp, C'67, associate dean of Arts and Science at the University of Pittsburgh; Rev. Martin R. Bartel, O.S.B., president of Saint Vincent College; Mrs. Ginger Burkhauser; Amy M. Sikora, C'96, a senior economic major from Pittsburgh; Kevin P. Kane, C'96, a senior economic major from Pittsburgh; and David M. Hansz, C'96, a senior economic major from Pittsburgh. Dr. Burkhauser is Professor of Economics at the Maxwell School of Syracuse University.

In 1908, a unanimous United States Supreme Court, in *Muller v. State of Oregon* (208 U.S. 412), held that state maximum hour legislation was constitutional, but only for women. In 1912, Massachusetts was the first state to establish a minimum wage law (unenforceable except by publicizing the offending employer's name) and by 1923, 14 other states, the District of Columbia, and Puerto Rico had established such laws. In 1923, the United States Supreme Court, in *Adkins v. Children's Hospital* (261 U.S. 525), ruled that the minimum wage law of the District of Columbia was unconstitutional. However, in time, the view espoused by the dissenting justices, including Holmes—that legislatures could regulate such contracts as long as the regulations were reasonable— prevailed.

In 1937, in *West Coast Hotel Co. v. Parrish* (300 U.S. 379), the United States Supreme Court upheld a state minimum wage law (Washington State) that applied only to women. In both the District of Columbia and the State of Washington, commissions had been established to set "standards of wages and conditions of labor for women and minors [which shall]...be reasonable and not detrimental to health and morals, and which shall be sufficient for the decent maintenance of women" (*West Coast Hotel Co. v. Parrish*, p. 387). In that five-to-four decision, the United States Supreme Court held that: "The legislature was entitled to adopt measures to reduce the evils of the 'sweating system,' the exploiting of workers at wages so low as to be insufficient to meet the bare cost of living..." (*West Coast Hotel Co. v. Parrish*, pp. 398-399). Thus, by 1938, popular support for the minimum wage was based not only on its potential to provide a living wage for the working poor but also on appellate court decisions which established that legislatures could actively intervene in the marketplace to correct perceived social injustice.

Franklin D. Roosevelt's impassioned speech calling on Congress to help the one-third of Americans who were "ill-housed, ill-clad, and ill-nourished" (Roosevelt 1937) heralded the Fair Labor Standard Act of 1938, and with it a national minimum wage for women and men. This marked the culmination of a long struggle by social reformers to establish the constitutional right of state legislatures to set a minimum wage and to garner the political support to pass minimum wage legislation at the national level. The debate then moved to who should be covered and at what rate.

> *"The Earned Income Tax Credit (EITC) offers a clear alternative to raising the minimum wage as a mechanism for tailoring a living wage for working Americans."*

Significantly, the power to establish coverage and to increase the minimum wage was not given to a commission of the type envisioned by social reformers like Ryan or like those established by earlier state laws. Rather, coverage and the level of the minimum wage were to be changed only by an act of Congress. World War II and its attendant inflation substantially reduced the effective minimum wage, and social reformers called for Congress to increase it. It is in the context of this social history that Stigler (1946) wrote.

The Minimum Wage and the Working Poor

Supporters of increases in the minimum wage over the last half of the twentieth century have been as concerned with maintaining a living wage for workers as reformers in the first half. For example, Senator Edward Kennedy, in criticizing the meagerness of the last increase in the minimum wage, declared in 1989 that:

> 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 adjustments 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 poor (*Congressional Record*, November 6, 1989, S14707).

Similarly, President Clinton emphasized the importance of a living wage when he declared in his 1995 State of the Union Address:

> I've studied the arguments and the evidence for and against a minimum wage increase. I believe that the weight of the evidence is that a modest increase does not cost jobs, and may even lure people into the job market. But the most important thing is, you can't make a living on $4.25 an hour (The White House, 1995).

These modern-day advocates of the minimum wage are repeating the historical justification of a minimum wage on grounds of social

justice and reflect the views of the majority of its supporters. The belief of policy makers and the public that minimum wage legislation helps the working poor explains their continued support. Their support, or the lack of it, has little to do with predictions from the economics profession with respect to employment loss. In evaluating the success of the minimum wage in the context of current social policy, the appropriate questions to ask are still those originally framed by Stigler (1946)—how does an increase in the minimum wage affect the working poor, and are there efficient alternatives to it?

Elsewhere, I have used data from the U.S. Census for the years 1940 through 1980 and various years of the *Current Population Survey* (CPS) to evaluate the link between the average hourly earnings of workers (aged 17 to 64) in the lower half of the earnings distribution and the economic well-being of their families as measured by an income-to-needs ratio (family income relative to the poverty level for a family of their size).

In 1939, the first year of the minimum wage, the correlation between wages of workers and their family's income-to-needs ratio was 0.207. By 1989 it had dropped to about one-fourth of that level—0.053. Family income, as Stigler (1946) pointed out, is dependent not only on the wage rate, but also on the number of hours worked, labor earnings of other family members, nonlabor income, and family size. The growth of multi-worker families and the introduction of government programs designed to provide lower income families with resources have dramatically weakened the relationship between the wage rates of workers and family well-being. This weaker relationship has reduced the ability of new minimum wage increases to target additional income to the working poor.

The weakness of the minimum wage as a mechanism for targeting income of the working poor is best seen by looking at how the last increase in the minimum wage, which increased hourly wages from $3.35 per hour to $4.25 per hour, affected workers across the income distribution.

"Who Gets What" from the Minimum Wage

Table 1 contains a sample of workers aged 16 and over taken from the 1990 Current Population Survey and arrayed by the income-to-needs ratio of their families. The income-to-needs ratio is the ratio of total family income divided by the official poverty line for a given family. In 1994, the poverty line for a family of four was $14,800. Therefore, a worker living in a family with four members and a total income of $44,400 would have an income-to-needs ratio of 3.0.

The hourly wages of all workers in the population aged 16 and over are shown across several income-to-needs categories. About seven percent of all workers earned wages between $3.35 and $4.25 per hour in 1990. While a small percentage earned less than $3.35 (2.1 percent), the vast majority of workers earned more

TABLE 1

WAGE DISTRIBUTION OF WORKERS BY THE INCOME-TO-NEEDS RATIO OF THEIR FAMILIES[a]

Income-to-Needs Ratio[b]	$0.01 to $2.99	$3.00 to $3.34	$3.35 to $4.24	$4.25 to $5.50	$5.51 to $9.99	$10.00 and Over	Total	Percent of All Workers	Percent of Affected Workers
Less than 1.00	4.8%	1.3%	25.8%	29.1%	28.8%	10.1%	100.0%	6.1%	22.0%
1.00 to 1.25	3.9%	0.8%	15.6%	25.5%	45.7%	8.6%	100.0%	2.8%	6.1%
1.25 to 1.50	3.7%	2.2%	14.9%	24.7%	43.7%	10.8%	100.0%	3.3%	6.9%
1.50 to 2.00	1.7%	1.1%	10.4%	22.7%	49.4%	14.7%	100.0%	8.2%	11.9%
2.00 to 2.99	1.8%	0.9%	8.1%	15.7%	47.6%	25.9%	100.0%	17.9%	20.3%
3.00 and Above	0.7%	0.5%	3.8%	6.7%	27.6%	60.7%	100.0%	61.7%	32.8%
Percentage of all workers	1.4%	0.7%	7.1%	12.1%	34.1%	44.5%	100.0%		

[a] Affected worker population are those working at the time of the survey whose wage rate ranged from $3.35 per hour to $4.25 per hour.
[b] The Income-To-Needs Ratio is calculated by comparing total family income to the relevant family size-adjusted poverty line.
Source: Outgoing rotation group of the March 1990 *Current Population Survey.*

than the proposed minimum wage of $4.25 per hour (90.8 percent).

The $3.35 to $4.25 column in Table 1 shows the percentage of workers in each income-to-needs category who are affected by the increase in the minimum wage. Workers who live in poor families are 3.6 times more likely to be helped by the minimum wage hike than the average worker (25.8 divided by 7.1). But Table 1 also shows that, as is the case with workers not living in poverty, the great majority of the working poor were **not** helped by a minimum wage hike to $4.25 since they already earned more than $4.25 per hour.

> *"Aside from nostalgia, it is hard to explain continued support for increasing the minimum wage by those interested in helping the working poor."*

The reason workers earning more than $4.25 per hour lived in poor families was not because they had a low wage rate. Rather, they either worked less than full-time or, even working full-time, had a family that was too large to be lifted above poverty despite their higher wage rate.

While it is certainly true that poor workers are more likely to earn a minimum wage, Table1 also shows that the vast majority of minimum wage workers do not live in poor or even in near-poor families. The reason is obvious—only 6.1 percent of **all** workers live in poor families and only about 12.2 percent of **all** workers live in near-poor (income-to-needs ratio between 1.0 and 1.5) or poor families.

About the same number of minimum wage workers live in families with incomes three times the poverty line (32.8 percent) as live in near-poor and poor families combined (35.0 percent). For this reason, minimum wage increases are extremely ineffective as a mechanism for reducing poverty.

Simply showing the distribution of affected workers overstates the share of benefits going to the families of the working poor if, on average, the marginal gain going to a worker in a poor family is lower than that going to a non-poor worker. This occurs either because the average wage of poor workers is relatively closer to the new $4.25 per hour minimum than that of non-poor workers or because the affected poor workers are working fewer hours. Further, the affected working poor may be more likely to suffer reduced hours or the loss of a job if there are negative employment consequences of a minimum wage hike.

These findings are consistent with Stigler's view that there is only a fuzzy relationship between a person's wage rate and the economic well-being of the family in which the person lives. Advocates of the minimum wage must recognize that such increases are not target-efficient and are even less so than they were half a century ago. Moreover, the role of government and the number of policy options available to reduce poverty have changed con-

About the Series

The Alex G. McKenna Economic Education Series is presented by the Center for Economic and Policy Education at Saint Vincent College. These periodic lectures are open to the general public and their purpose is to explore the role of free markets in solving many of the social problems confronting the United States, and the world today. Dr. Gary M. Quinlivan, professor of economics at Saint Vincent, directs the series.

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siderably since the late nineteenth and early twentieth centuries. Today, the appropriate question to ask is what alternatives to minimum wage hikes are available to help insure a living wage for the working poor.

The EITC vs. the Minimum Wage

The Earned Income Tax Credit (EITC) offers a clear alternative to raising the minimum wage as a mechanism for tailoring a living wage for working Americans. Table 2 uses the same Current Population Survey data to compare the distributional effects of a simulated increase in the minimum wage to a simulation of benefits resulting from legislative changes in the EITC program between 1989 and 1992. The counter factual question is what effect these programs would have if they had been immediately adopted.

In 1989, the minimum wage was $3.35 per hour. The 1989 Amendments to the Fair Labor Standards Act (FLSA) increased it to $4.25 by 1992. In the first two columns of Table 2, the effects of increasing the minimum wage from $3.35 to $4.25 are simulated. In our simulation, we assume there are no employment effects. Our results indicate that less than 20 percent of the total benefits accrue to poor families and 34 percent to poor and non-poor families combined. In comparison, 32 percent of the benefits go to families with income-to-needs ratios greater than 3.0 and 66 percent to families with an income more than 150 percent of the relevant poverty line.

In contrast, the EITC supplements the wages of low-wage workers who live in low-income families with children. In 1989, an eligible minimum wage worker who lived in a family with income below $7,520 actually received $3.82 for an hour's work—$3.35 plus a 14 percent tax credit. Between 1989 and 1992, Congress increased the EITC marginal credit rates from 14 to 17.6 (18.4) percent for eligible workers with one (two or more) child. Hence, even if the 1989 FLSA amendments had not been adopted, EITC-eligible minimum wage workers would still have seen their hourly wages grow to $3.94 for a family with one child and $3.97 for a family where two or more children were present.

The maximum EITC in 1992 was $1,324 (17.6 percent of $7,520) for taxpayers with one child and $1,384 (18.4 percent of $7,520) for taxpayers with more than one child. In 1992, the EITC began to be phased out at an earned or adjusted gross on income of $11,840 at the rate of 12.57 cents per dollar for those with one child and 13.14 cents per dollar for those with two or more children. All benefits were phased out at $22,370.

Columns 3-6 in Table 2 show how the gains from changes in the EITC between 1989 and 1992 would have been allocated across families with different income-to-need ratios in the absence of the 1989 amendments to the FLSA. Consistent with our minimum wage simulations, we assume that the EITC has no effect on employment. We also assume that all eligible families receive the credit.

TABLE 2

SIMULATED DISTRIBUTION OF BENEFITS FROM AN INCREASE IN THE MINIMUM WAGE AND THE EARNED INCOME TAX CREDIT

	Affected Workers' Households[a]				Total Population[b]	
	Wage Increase from $3.35 to $4.25		Change in EITC Rules from 1989 to 1992			
Income-to-Needs Ratio[c]	Total Benefit (billions of dollars)	Percent of Affected Households	Marginal Benefit (billions of dollars)	Percent of Affected Households	Marginal Benefit (billions of dollars)	Percent of Total Population
Less than 1.00	$0.658	19.3%	$0.253	41.3%	$1.022	25.3%
1.00 to 1.25	$0.289	8.4%	$0.088	14.4%	$0.669	16.6%
1.25 to 1.50	$0.220	6.4%	$0.076	12.4%	$0.637	15.8%
1.50 to 2.00	$0.419	12.2%	$0.124	20.2%	$0.887	22.0%
2.00 to 3.00	$0.726	21.2%	$0.062	10.1%	$0.620	15.3%
Greater than 3.00	$1.110	32.5%	$0.010	1.6%	$0.205	5.0%
All Households	$3.422	100.0%	$0.613	100.0%	$4.040	100.0%

[a]Affected worker population are those working at the time of the survey whose wage rate ranged from $3.35 per hour to $4.25 per hour.
[b]Total Population includes all households except those in the military.
[c]The Income-to-Needs Ratio is calculated by comparing total family income to the relevant household size-adjusted poverty line
Source: Outgoing rotation groups of the March 1990 *Current Population Survey.*

Column 5 shows that increases in EITC benefits would have cost taxpayers $4.04 billion. Column 6 shows how those benefits were distributed across different income-to-needs categories. Workers living at or near the poverty line received 58 percent of all dollars from the EITC, while those living in families with an income-to-needs ratio greater than 3.0 received only 5 percent. This contrasts sharply with the distribution of benefits from the 1989 minimum wage hike, in which upper-income families with income-to-needs greater than 3.0 received 60 percent more than poor families.

EITC increases provided five times more benefits to workers in poor families than to workers in higher income families.

A major advantage of an EITC approach to insuring a living wage to the working poor is that it achieves, by means of a family size-adjusted credit and an income test, far greater target effectiveness than simple across-the-board increases in the minimum wage. Table 2 shows how critical this family income-based help is to the working poor. When we focus only on the population of workers who are helped by a boost in the minimum wage, we see in column 4 that 41.3 percent of EITC benefits go to the working poor compared to

19.3 percent of the minimum wage hike, a relative increase of more than 100 percent. This subpopulation of the working poor whose hourly wage rate was between $3.35 and $4.25, however, receives only one-quarter of the total benefits going to the working poor (.25 billion of 1.02 billion). The rest go to poor families with workers who have wage rates above $4.25 but who, because of low hours or a large family, still live in poverty. Additional benefits go to those not covered by the minimum wage who earn less than $3.35 per hour.

The EITC, by supplementing the market wage of workers whose income falls below a prescribed level, can be thought of as a *targeted minimum wage*. In 1993, a bipartisan majority of Congress passed a proposal of the Clinton Administration to increase the EITC. By 1996, these changes will raise the effective minimum wage for those eligible for a two-child EITC credit from $4.25 to $5.95 per hour.

The Future of Minimum Wage Legislation

Enactment of the minimum wage established a milestone in the institutional relationship within which binding market contracts are made in the United States. I doubt if the majority of those now opposed to further increases in the minimum wage are anxious to end the federal government's power to limit freedom of contract as it has been accepted over the last half century, although some may. Likewise, I doubt if the majority of those in favor of increasing the minimum wage would argue that Ryan's turn-of-the-century picture of the American labor market as dominated by a "perverse individualism which prefers irrational liberty and industrial anarchy to a legal regime of order and justice" is still accurate and would seek additional industrial policy set by government commission, although some might.

Rather, America over the last century, in contrast to many European countries, has rejected the use of government-mandated "industrial

partners" to establish wage-setting patterns in the economy. This vision of the labor market, which was much in the spirit of the turn-of-the-century socialists who were among those advocating minimum wage laws as a mechanism to that end, failed to take root in the United States. In fact, the minimum wage has increasingly become an anachronism with respect to either redistributing income or protecting workers against poverty in the United States. The federal income tax has, for the most part, been the principal tool of redistribution in the United States. The negative income tax and more recently the EITC have each been seen as alternative methods of targeting wage subsidies to the working poor. Aside from nostalgia, it is hard to explain continued support for increasing the minimum wage by those interested in helping the working poor. It is time to relegate the minimum wage to the museum of antiquated policies and use the EITC as a method of making work pay.

Center Announcement

Future Alex G. McKenna speakers include Dr. Donald J. Mullineaux, C'67, the DuPont Chair in Banking and Financial Services at the University of Kentucky (February 14, 1996, "Is Bill Gates Right: Is Banking a Dinosaur?"), and Dr. Richard W. Tresch, Chairperson of Economics at Boston College (March 6, 1996, "Welfare Reform: Shared Views and Disagreements").

As part of the Center's Government and Political Education Series, on February 1, 1996, Dr. Fred Miller, Professor of Philosophy at Bowling Green University, will deliver a lecture based on his latest book *Nature, Justice, and Rights in Aristotle's Politics*, published by Oxford University Press, 1995.

The deadline for registration for the Alex G. McKenna Economic and Policy Scholarship Award ($2,500. per year for four years of undergraduate study at Saint Vincent College) essay competition was November 8, 1995. Candidates wrote an essay which critically assessed the economic proposals of one of the presidential candidates.

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