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Issues and Allegations: Minimum Wage

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WHY WE USE "CONSERVATIVE" AND "LIBERAL"

Background

In 1938 the Fair Labor Standards Act (FLSA) established a national minimum wage and maximum hour standard. The initial minimum wage was 25 cents per hour, about 40 percent of the 1938 average manufacturing wage. Today the minimum wage stands at \$5.15 an hour, about 33 percent of the 2003 average wage.

Unlike social security payments, the minimum wage does not automatically increase to keep pace with inflation. Congress must act for it to rise. Since 1938 Congress has done so 17 times, the last time in 1996. At times almost a decade has passed between increases. During that time the effective purchasing power of the minimum wage can drop significantly. In real (inflation-adjusted) dollars, the value of the minimum wage peaked in 1968 at \$8.46 (in 2003 dollars). **Click here for a chart showing the minimum wage in current and constant dollars from 1938 to 2004.**

Originally the FLSA covered less than half the work force. Over the decades Congress expanded coverage several times. Today more than 90 percent of private employees are covered.[1]

All but seven states have their own minimum wage laws.[2] A majority sets the level equal to that of the FLSA. Twelve boast higher minimums.[3] Two states require lower minimum wages than the federal government.[4]

Where an employee is subject to both federal and state minimums, the employee is entitled to the higher of the two.[5]

About 7 million people currently earn the minimum wage. Millions more earn just above the minimum. About 8 percent of men and 13 percent of women earn the minimum wage. Sixty percent are below

At a Glance...

The conservative view:

- The market is the best mechanism for setting wage levels.
- Raising the minimum wages reduces employment for those most in need: teenagers, people of color, women.
- Teenagers earning the minimum wage typically need the experience and training offered by entry-level jobs more than they need a higher wage.
- The minimum wage is not an effective tool for fighting poverty since few poor people hold full time jobs.
- Minimum wage increases primarily benefit individuals whose family income is above the poverty level.
- Since the Earned Income Tax Credit (EITC) targets working families with young children, it is a more effective tool for fighting poverty than raising the minimum wage.

The liberal view:

- Hiking the minimum wage is an effective tool for reducing poverty; the poorest 20 percent of households disproportionately benefit.
- Raises in the minimum wage affect ripple through the work force, benefiting not only those who earn the minimum wage but millions more in slightly higher wage brackets.
- The benefits of significantly higher wages far outweigh the costs of the few jobs that might be lost.
- Growing numbers of studies have found that raising the minimum wage actually may slightly boost employment. In light of the mounting evidence, economists are altering their traditional position about the adverse impact of the minimum wage on jobs.
- Raising the minimum wage is an effective economic stimulus tool

the age of 25. One third are teenagers.

because low-income workers are likely to spend any extra money they receive right away.

The Problem

The minimum wage has not increased in eight years. Its effective buying power has dropped to its lowest level since 1949.

The Conservative Perspective

Conservatives maintain that wage levels are best established by the market. Matthew Kibbe of the Center for the Study of Market Processes sums up the argument, "Employers attempt to purchase the specific skills they need at the lowest available price, while individuals selling their labor attempt to find the highest-bidding employer. Every market price, including a wage, is simply the outward expression of what employers perceived to be consumers' preference. If consumers do not value a particular good or service offered on the market, labor, as well as the other factors involved in producing the good, will be worth little. Thus, it is the individual—the sovereign consumer—who has the final say in determining wages."**[6]**

Conservatives contend that minimum wage laws are an inefficient and ineffective tool for fighting poverty. Some 60 percent of the poor do not work. Moreover, as Richard Vedder and Lowell Gallaway of the National Center for Policy Analysis note, "Minimum wage workers are not parents struggling to feed their children. Rather, they are high school or college students living at home. The level of the minimum wage is irrelevant for most people in poverty. Only 9.2 percent of poor people of working age have full-time jobs." Almost 60 percent of the minimum wage increase from \$3.35 to \$4.25 in the early 1990s went to families with incomes at least twice the poverty level. Only 17 percent went to families below the poverty level.**[7]**

For conservatives the Earned Income Tax Credit (EITC)**[8]** is a better tool for alleviating poverty than the minimum wage. It allows government to target assistance to the small portion of the workforce raising families on low incomes instead of inefficiently and indiscriminately distributing assistance to individuals without children or above the poverty level.**[9]**

Conservatives argue that people earning the minimum wage often need the experience and training offered by entry-level jobs more than the money itself. People who make \$5.15 an hour are typically looking for experience or extra money not a "living wage" insists the Employment Policies Institute.**[10]** "The overwhelming majority of minimum wage earners are teenagers holding their first job which allows them the opportunity to 1) develop good work habits early in life; 2) gain experience in order to move on to better paying jobs; and 3) develop self-reliance", explained the Joint Economic Committee of Congress (JEC) in a brief issued in 1995.**[11]**

When the government artificially raises wages it actually hurts those most in need. "When wages are increased by fiat there is no accompanying increase in productivity. The employer can replace low wage workers with more productive workers. Or substitute machines or just cut back", observe economists Donald Deere, Kevin Murphy and Finis Welch in Regulation magazine..**[12]** They point to one study that examined the impact of the increase from \$3.35 to \$3.80 in the minimum wage in the early 1990s. The increase resulted in 4.8 percent fewer teenage men, 7.5 percent fewer teenage blacks and 6.6 percent fewer teenage women employed.

Dr. Peter Brandon of the Institute for Research on Poverty found that in those states that raised the minimum wage mothers remained on welfare 44 percent longer than in states where it was not raised.**[13]** A Joint Economic Committee brief explains, "The reason for this result is that raising the minimum wage induces some people to enter the labor market who would not apply if not for the higher level. With a larger labor market, employers choose higher-skilled applicants. Thus raising the minimum wage hurts low skilled workers in two ways. First, there are fewer jobs available. Second, with a larger pool of applicants, competition is stiffer."

In 1981 the Congressionally-mandated Minimum Wage Study Commission issued its seven-volume report. Some of its studies estimated a reduction in teenage employment of 1-3 percent for every 10 percent increase in the minimum wage.**[14]** Thus the 90 cent increase in the minimum wage, from \$4.25 to \$5.15 an hour, a 21 percent increase, would result a loss of 130,000-400,000 teen jobs.**[15]**

After examining many past academic studies of the relationship between minimum wages and employment the Joint Economic Committee concluded, "The impact of raising the minimum wage has been studied since its inception. All credible research has come to the same conclusion: raising the minimum wage hurts the poor. It takes away jobs, keeps people on

welfare and encourages high-school students to drop out.”[16]

Liberal Perspective

Liberals maintain that minimum wage hikes can help alleviate poverty. As Henry J. Aaron, an economist at the Brookings Institution notes “If your objective is to make work pay well enough so that it takes fewer earners in a family to keep the family out of poverty, then raising the minimum wage is a worthy goal.”[17]

Liberals note that just under half (46%) of those earning minimum wages in the mid 1990s worked full time. Another third worked 20 to 34 hours per week. The average minimum wage worker is responsible for providing more than half (54%) of his or her family's weekly earnings. The two stage increase in 1996-1997 disproportionately benefited low-income households. While households in the bottom 20 percent of the income distribution (average income \$15,728) receive only 5 percent of total family income, they received 35 percent of the benefits from the minimum wage increase.[18]

Liberals note that minimum wage increases benefit not only those earning the minimum wage but millions more in modestly higher wage brackets. The Economic Policy Institute concluded that the two step minimum wage increases in 1996 and 1997 raised the wages of almost 10 million workers.[19]

As for the minimum wage's impact on employment, EPI maintains, “Not only are the estimated employment effects generally economically small and statistically insignificant, they are also almost as likely to be positive as negative.” Nobel Laureate economist Robert Solow of MIT observes, “The main thing about the research is that the evidence of the job loss is weak...And the fact that the evidence is weak suggests the impact on jobs is small.”[20]

Liberals point out that even if the figure widely used by conservatives of a 1 percent reduction in teen employment from a 10 percent increase in the minimum wage were valid it would indicate that the benefits far exceed the costs.

A growing number of economists, spurred on by the studies of David Card and Alan B. Krueger in the late 1980s and early 1990s, are accepting that higher minimum wages could boost employment.[21] Former Vice Chairman of the Federal Reserve and Princeton economist Alan S. Blinder observes that some 20 different studies by two dozen authors have produced similar results to those of Card-Krueger. Blinder explains why jobs might not be lost despite the increase in wages. Paying a higher minimum wage might reduce job turnover enough to pay for itself by avoiding the high costs of training new workers, leaving companies with no incentive to reduce employment. Also employers might not be willing to offer higher pay to attract new workers if all existing workers have lower wages. Raising the minimum wage makes this potential problem moot. Finally, minimum wage labor may constitute such a small and relatively fixed proportion of costs that an increase only marginally affects overall costs.[22]

A recent survey of 1,000 economists found a significant change in their position on the tradeoff between the minimum wage and unemployment in the last decade.[23] In 1990 almost 63 percent of those surveyed agreed with the statement, “Minimum wages increase unemployment among young and unskilled workers.” By 2000 agreement had fallen to about 45 percent.

Proponents of higher minimum wages also see it as an effective strategy for generating employment in a sluggish economy. Low-income workers are more likely to spend any additional resources they might receive. Therefore, higher minimum wages would “result in greater immediate economic stimulus per dollar of cost than tax cuts for high-income individuals.”[24]

Liberals support current legislation (HR 965 and S 224) that would raise the current \$5.15 minimum wage in two stages to \$6.65.

Notes and Sources

- **A note on internet citations**

[1] Some seasonal, domestic and a few other types of workers remain exempt.

[2] Alabama, Arizona, Florida, Louisiana, Mississippi, South Carolina and Tennessee have no minimum wage. **State minimum wage rates** (US Dept. of Labor)

[3] Arkansas, California, Connecticut, Delaware, Hawaii, Illinois, Maine, Massachusetts, Oregon, Rhode Island, Vermont, Washington, the District of Columbia. Washington boasts the country's highest minimum wage, \$7.16 an hour.

[4] Kansas and Ohio have a lower state minimum wage.

[5] Various minimum wage exceptions apply. An employer of a tipped employee, for example, is only required to pay \$2.13 an hour in direct wages if that amount plus the tips received equals at least the federal minimum wage, the employee retains all tips and the employee customarily and regularly receives more than \$30 a month in tips. A minimum wage of \$4.25 per hour applies to young workers under the age of 20 during their first 90 consecutive calendar days of employment with an employer, as long as their work does not displace other workers. After 90 consecutive days of employment or the employee reaches 20 years of age, whichever comes first, the employee must receive a minimum wage of \$5.15 per hour.

The minimum wage law applies to employees of enterprises that do at least \$500,000 in business a year. It also applies to employees of smaller firms if the employees are engaged in interstate commerce or in the production of goods for commerce.

[6] Matthew Kibbe. **"The Minimum Wage: Washington's Perennial Myth."** Cato Policy Analysis No. 106. *Cato Institute*. May 23, 1988.

[7] Gallaway, Lowell & Vedder, Richard. "Should the Federal Minimum Wage Be Increased?" *National Center for Policy Analysis*. Dallas TX 1995.

[8] The Earned Income Tax Credit (EITC) is a refundable Federal tax credit for eligible individuals and families who work and have earned income under \$33,692 (\$34,692 for married filing jointly). The EITC reduces the amount of tax you owe, and it may give you a refund. The EITC offers higher refunds to workers with lower taxable incomes.

[9] **"The History of the Nominal and Real Value of the Minimum Wage Including the Real Value of the Earned Income Tax Credit."** *Employment Policies Institute*.

[10] Ralph Smith & Bruce Vavrichek. "The Minimum Wage: Its Relation to Incomes and Poverty." *Monthly Labor Review* vol. 110. June 24-30, 1987.

[11] The Joint Economic Committee of Congress, under the auspices of Republican Vice Chair Representative Jim Saxton of New Jersey issued several briefs on unemployment in the mid 1990s. *50 Years of Research on the Minimum Wage*. February 15, 1995. *The Minimum Wage: Part 1 and Part 2 Talking Points* February 16 and February 21, 1995. *The Case Against a Higher Minimum Wage*, May 1996. *Raising the Minimum Wage: The Illusion of Compassion*, April 1996

[12] Donald Deere, Kevin M. Murphy, & Finis Welch. "Sense and Nonsense on the Minimum Wage Regulation," *The Cato Review of Business & Government*. Vol 18. No. 1. 1995.

[13] Peter Brandon. "Jobs Taken By Mothers Moving from Welfare to Work and the Effects of Minimum Wages on this Transition." *Employment Policies Institute*. Washington, D.C. 1995.

[14] Charles Brown, Curtis Gilroy & Andrew Kohen. "Effects of the Minimum Wage on Youth Employment and Unemployment", *Minimum Wage Study Commission*. 1981. Vol. 5. Found that a 10 percent increase reduces teenage employment by 1-3%. Another study by the same authors in the same volume, *Time-Series Evidence of the Effect of the Minimum Wage on Teenage Employment and Unemployment* found that a 10 percent increase results in a 1 percent reduction in teen employment

[15] *Raising the Minimum Wage: The Illusion of Compassion*, Joint Economic Committee, U.S. Congress. Washington, D.C. April 1996.

[16] *The Case Against a Higher Minimum Wage*, Joint Economic Committee. 1996. Joint Economic Committee, Congress, *Raising the Minimum Wage: The Illusion of Compassion*, April 1996.

[17] Louis Uchitelle. "A Pay Raise's Impact." *New York Times*. January 12, 1995.

[18] Jared Bernstein and John Schmitt. **"Making Work Pay: The Impact of the 1996-97 Minimum Wage Increase"**. *Economic Policy Institute*. 1998. See also the *Economic Policy Institute's "Issue Guide: Minimum Wage"*

[19] Bernstein and Schmitt, *Op. Cit.*

[20] Louis Uchitelle., "A Pay Raise's Impact". *New York Times*. January 12, 1995.

[21] See David Card & Alan Krueger, *Myth and Measurement: The New Economics of the Minimum Wage*. Princeton University Press. Princeton 1995. Also David Card, "Do Minimum Wages Reduce Employment? A Case Study of California 1987-1989", *Industrial and Labor Relations Review* vol. 46 (October) 38-54. David Card and Alan B. Krueger, Minimum Wages and Employment: A Case Study of the Fast-Food Industry in New Jersey and Pennsylvania. *American Economic Review*. Vol 84 September 1994. 772-793

[22] Alan Blinder, New York Times. May 23, 1996

[23] Dan Fuller and Doris Geide-Stevenson, "Consensus among economists: revisited", *The Journal of Economic Education*, September 22, 2003. A two-page questionnaire consisting of 44 economic propositions was mailed in September 2000 to a random sample of 1,000 economists taken from the American Economic Association's membership roster. Each recipient was asked to indicate whether she or he mainly agreed, agreed with provisos or generally disagreed with each of the 44 propositions. About 58 percent of our respondents were employed in academia, 16 percent in government, and 21 percent in the private sector.

[24] Isaac Shapiro and Sharon Parrott, "**Are Policies That Assist Low-Income Workers Receiving Appropriate Priority?**" *Center for Budget and Policy Priorities*. August 29, 2003.



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