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THE MINIMUM WAGE HIKE: GOOD FOR THE WORKING POOR OR MIDDLE-CLASS TEENS?

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There are two ways to view the minimum wage and its effects on the job market: by way of the familiar “classical” theory, and the newer “search” model. But while the two theories differ considerably, they both predict that increases in the minimum wage, as proposed in Senate Bill 89, make it more difficult for the working poor—whom minimum wage increases are meant to benefit—to find jobs. At the same time, the value of these entry-level jobs for poor individuals goes far beyond the admittedly modest wages. In balancing the desire to boost wages for unskilled workers versus keeping these jobs available for the working poor, the legislature should opt to preserve jobs for the working poor.

The “classical” model of the effect of minimum wages on the market for unskilled labor is fairly familiar: it predicts that as wages increase, more workers are willing to accept jobs and the pool of available labor increases. At the same time, employers are less likely to hire employees at a higher wages. A minimum wage above this equilibrium level will draw more potential workers into the labor pool, but at the same time employers will reduce their use of unskilled labor: perhaps by hiring more skilled workers, using more machinery, or even reducing the level of service they offer customers. The result in this model is fewer jobs for unskilled workers.

In recent years this classical model has come under question. Economists studying statistical evidence on the effects of minimum wage hikes at both the federal and state levels have yet to reach a consensus on whether employment numbers back up the predictions of the classical model. Some economists have even claimed to have found evidence that minimum wage increases have led to increases in the number of jobs available to unskilled workers, something that simply shouldn’t happen under the classical model. Advocates of the traditional model will concede that a particularly strong economy with strong overall job growth can “obscure” jobs lost by an increased minimum wage.

For instance, the rate of employment for teenagers dropped sharply when the minimum wage was raised, in two stages, from \$3.35 to \$4.25 an hour in 1990 and 1991, but when the minimum wage was increased again, to the current \$5.15 in 1996 and 1997, the employment rate for teenagers held steady.¹ The difference was that the latter minimum wage hike occurred in the midst of an economic boom. (In both cases, teens fared worse than adults, who are less likely to be affected by the minimum wage, and then recovered when minimum wage rates were held steady.)

This controversy led Duke economists Peter Arcidiacono and Thomas Ahn to create what they

1. Mark Wilson, *Who is Paid the Minimum Wage and Who Would Be Affected by a \$1.50 per Hour Increase?* Heritage Foundation, June 28, 2001.

call the “search” model of minimum wages, where the number of jobs available to unskilled workers is not determined solely by the willingness and ability of employers to pay a given wage, but also by the ability of employers and employees to “match-up.”² Under this model, it is conceivable that, with an increased minimum wage drawing job-hunters out of the woodwork, more job hunters will find “matches,” leading to an increase in jobs. But there is a catch: the new job hunters are less likely to be working poor and much more likely to be teenagers from middle-class and well-to-do families. So even if the number of unskilled jobs increases, the poor are likely to find themselves squeezed out of them.

As things stand now, relatively few minimum wage workers are poor. A Heritage Foundation analysis of 2003 U.S. Census data shows that, of 7.8 million American workers receiving an hourly wage of less than \$6.65 an hour, only 15 percent are currently living in poverty. Nearly three-quarters of these workers, 72 percent to be precise, have a family income that is at least 50 percent higher than the poverty line, and over half belong to families earning double the poverty level. One fifth of low-income workers belong to families earning over \$80,000 annually. The average family income of the typical low-wage worker was a respectable \$40,000 per year.³

Both the classical model and Arcidiacono and Ahn’s “search” model agree that higher minimum wages attract new potential workers into the labor force, but where do these workers come from? There is reason to believe that the new job seekers are even more likely to be from well-off families. Arcidiacono and Ahn note that these new workers will tend to have a higher “reserve” wage than those who found work under the lower minimum wage. In other words, they were willing to forego working while the wage was low. Such an individual is likely to have been reasonably well-off without working—otherwise he or she would have probably been in the labor force already—and this would in turn mean that the new work force would be dis-

proportionately composed of relatively well-off teenagers and as opposed to poor workers.

This conclusion matches the results of a study of minority and inner city teenagers during the early 1990s, which found that increases in the minimum wage increased the likelihood that they would be idle (neither working nor attending school), while white teenagers and those living outside of central cities were more likely to either be in school or working after a minimum wage increase.⁴

Whether it happens because a higher minimum wage reduces the overall number of unskilled jobs, or because the higher wage attracts teenagers from well-off families who crowd out poorer job-seekers, the effect is the same: an increased minimum wage constrains employment opportunities for poor families.

Lawmakers should not underestimate the value of these jobs to low-income families, a value that goes well beyond the admittedly modest wages; low wage work is often a pathway out of poverty. Experience and reputation earned in entry-level jobs can and frequently does lead to more lucrative jobs. Low-wage earners frequently see their wages rise quickly; full-time workers hired at the minimum wage received a median pay increase of 10.4 percent within their first year, which shows that low-wage employees are able to work through minimum wage jobs into better ones.⁵

U.S. lawmakers would be wise to allow this process to continue. While most supporters of minimum wage increases, such as the sponsors of SB 89, probably mean well, the truly humanitarian response is to maintain the current minimum wage and leave as many jobs as possible for poor, unskilled workers who wish to join the labor force and begin the process of working their way out of poverty.

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2. Peter Arcidiacono and Thomas Ahn, *Minimum Wages and Job Search: What Do Employment Effects Really Measure?* Employment Policies Institute, 2004.
3. Paul Kersey, *Testimony Before the House of Representatives; Small Business Committee; Subcommittee on Workforce, Empowerment, and Government Programs*, May 3, 2004.
4. Mark Turner and Berna Demiralp, *Higher Minimum Wages Harm Minority and Inner-City Teens*, Employment Policies Institute, 2001.
5. William E. Even and David A. McPherson, *Wage Growth Among Minimum Wage Workers*, Employment Policies Institute, 2004.