

TESTIMONY OF STEPHEN HERZENBERG
Senate Labor and Industry Committee
Minimum Wage Hearing
Tuesday, September 6, 2005
Temple Student Center (Philadelphia), Room 217

My name is Stephen Herzenberg and I hold a Ph. D. in economics from the Massachusetts Institute of Technology and a BA from Harvard College. I am the executive director of the Keystone Research Center (KRC), a non-partisan economic think tank based in Harrisburg. I very much appreciate the opportunity to testify before you today.

My remarks today are adapted from *The State of Working Pennsylvania 2005* (hereafter, *SWP2005*), an annual report on the health of the Pennsylvania economy and labor market that KRC released this past weekend.

(*SWP2005* is available online at www.stateofworkingpa.com or via the KRC home page, www.keystoneresearch.org. Sections of the report will also be excerpted shortly on a third special web page, www.paminimumwage.com. This last URL will be a continuing source of information and links on the minimum wage during the legislative discussion of this issue.)

One of the critical findings of *SWP2005* that relates to the topic of today's hearing is that Pennsylvania wages fell pretty much across the board last year. Wages declined for the third year in a row at the low end of the labor market, so that a worker making \$7.31 in inflation-adjusted 2004 dollars in the year 2001 was making only \$7.16 in 2004. That's a \$300 a year difference. Not much except when your annual pay is less than \$15,000 per year. Pennsylvania low-wage earners (defined as those earning more than 10 percent of earners and less than 90 percent) make less now than they did in 1979.

But wage stagnation is not just low-wage earners' experience. Median wage earners now make all of 9 cents per hour in inflation-adjusted dollars than in 2001. High-wage earners (who make more than 90 percent of all workers) make \$1.33 less than in 2002.

Recent wage trends, along with slow job growth, helps explain why Pennsylvania median household income has fallen 5 percent since 2001 and why poverty climbed roughly 20 percent between 1999-2000 and 2003-04.

These wage, income, and poverty trends have been accompanied by profits climbing to record levels and the CEOs of Fortune's list of the 500 biggest U.S. companies enjoying a hike in pay from \$6.6 million to \$10.2 million. Nice work if you can get it.

The economic realities of ordinary Pennsylvanians shed some light on the popular reaction to the legislative pay increase enacted in July. Figure 1 below contrasts the base pay for members of the General Assembly against the annual earnings of a full-time minimum-wage worker and median-wage worker since the late 1970s. While legislative pay fluctuates a lot, it trends up substantially. The other two lines do not.

Recent wage trends also underscore how timely is the discussion today about raising the state minimum wage.

Turning to the topic of the state minimum wage, I will structure most of my remarks around the three questions the General Assembly asked the Minimum Wage Advisory Commission to address when it established the Commission in July. (I have to admit to a little nervousness when answering three questions. I remember the fate of the knight in *Monty Python and the Holy Grail* who, when asked to "answer me these questions three," got his favorite color wrong. Trusting that my answers are right and that, in any event, I won't be plunged into the gorge I will sally forth nonetheless.)

Background on the Minimum Wage

Before getting to those three questions, some brief background on the minimum wage.

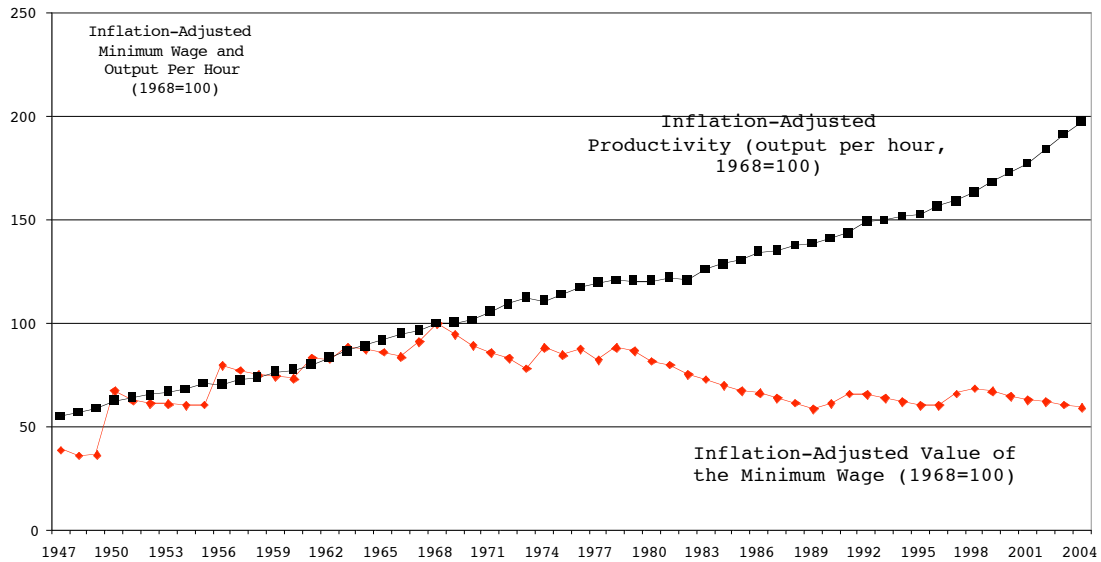
Experience over the past 25 years indicates that earnings go up at the bottom end of the labor market in two circumstances: when the minimum wage is increased and in periods of sustained low unemployment. Since 2001, Pennsylvania has had neither a strong job market nor any increases in its minimum wage.

Because the federal government has not acted to raise the minimum wage since 1997, and because inflation has eaten away at the value of the federal rate, a growing number of states have taken action to raise their minimum wage above the federal level (Table 1). The states with a minimum wage above the federal level today have a combined population of 131 million people, nearly half (46 percent) of the U.S. population excluding Pennsylvania.

Table 1. State Minimum Wage Rates, 1997-2007											
	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
United States	5.15	5.15	5.15	5.15	5.15	5.15	5.15	5.15	5.15		
Alaska	5.65	5.65	5.65	5.65	5.65	5.65	7.15	7.15	7.15	**	**
California	*	5.75	5.75	5.75	6.25	6.75	6.75	6.75	6.75		
Connecticut	*	*	5.65	6.15	6.4	6.7	6.9	7.1	7.1	7.4	7.65
District of Columbia	6.15	6.15	6.15	6.15	6.15	6.15	6.15	6.15	6.6	7	
Delaware	*	*	5.65	6.15	6.15	6.15	6.15	6.15	6.15		
Florida	*	*	*	*	*	*	*	*	6.15	***	***
Hawaii	5.25	5.25	5.25	5.25	5.75	5.75	6.25	6.25	6.25	6.75	7.25
Illinois	*	*	*	*	*	*	*	5.5	6.5		
Maine	*	*	*	*	*	5.75	6.25	6.25	6.35		
Massachusetts	5.25	5.25	5.25	6	6.75	6.75	6.75	6.75	6.75		
Minnesota	*	*	*	*	*	*	*	*	6.15		
New Jersey	*	*	*	*	*	*	*	*	6.15****	7.15	
New York	*	*	*	*	*	*	*	*	6	6.75	7.15
Oregon	5.5	6	6.5	6.5	6.5	6.5	6.9	7.05	7.25	***	***
Rhode Island	*	*	5.65	6.15	6.15	6.15	6.15	6.75	6.75		
Vermont	*	5.25	5.75	5.75	5.75	6.25	6.25	6.75	7	7.25	***
Washington	*	*	5.7	6.5	6.72	6.9	7.01	7.16	7.35	***	***
Wisconsin									5.7	6.5	
* Same as or lower than federal rate. (Before 1999, Connecticut's minimum wage was 1-3 cents above the federal rate).											
** At least \$1 above federal rate											
*** Indexed to inflation											
**** As of October 2005											
Source: Jeff Chapman, Economic Policy Institute.											

Debates about the minimum wage today tend to be framed in terms of whether the minimum keeps pace with inflation, the implicit judgment being that minimum wage workers shouldn't get any poorer. In the quarter century after World War II, however, American policy met a much higher standard -- that low-wage workers should share roughly equally in the benefit of an expanding economic pie. Over this period, the minimum wage tracked the growth of productivity -- i.e., the average value of output produced each hour by each worker. Since productivity grew at 3 percent per year, so did the inflation-adjusted wages of minimum wage workers (Figure 7).

Figure 2. Inflation-Adjusted Minimum Wage and Productivity, 1947-2004 (Indexed to 1968 = 100)



Note: In this figure, inflation adjustments are made using the CPI-U since the CPI-U-RS is not available back to 1947.

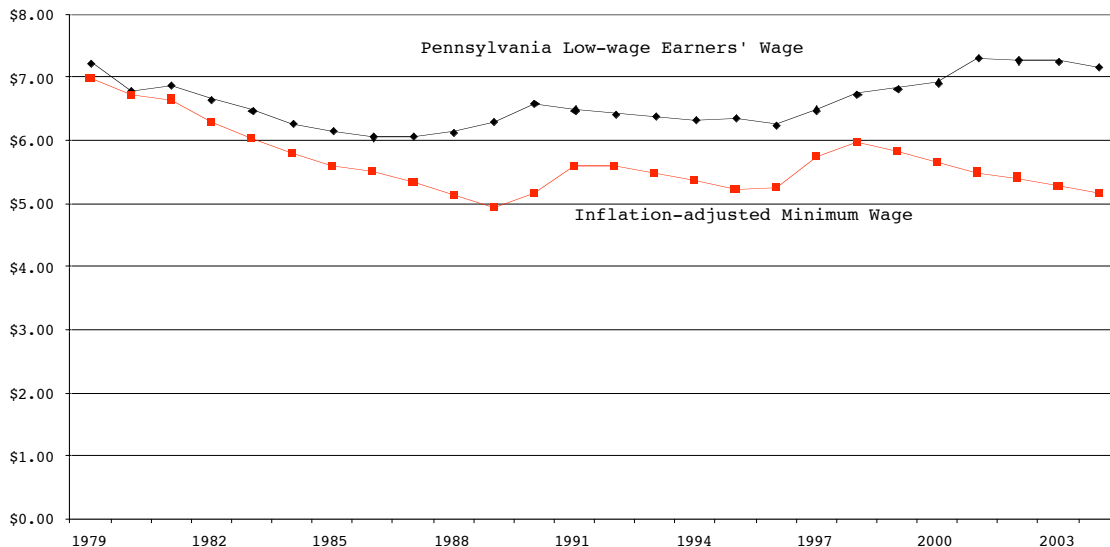
Source: KRC analysis of BLS productivity data and federal minimum wage data.

Since 1968, the minimum wage has lost roughly two-thirds of its value relative to national productivity. Since 1968, the minimum wage has also lost 41 percent of its value relative to inflation.

Despite its erosion, the minimum wage remains a powerful instrument for raising workers' wages at the low end of the labor market. Figure 3 shows the minimum wage in inflation-adjusted terms since 1979 compared to the Pennsylvania low-wage earners' wage. It shows that the erosion of the federal minimum wage by inflation in the 1980s went along with an erosion in low-wage worker's earnings that was only arrested by consistent economic growth from 1984 to 1989.

Since 1990, the minimum wage and low-wage earnings have again tended to move together, the exceptions being 1991 and the 1999 to 2001 period. In 1991, an economic slowdown overshadowed the effect of a higher minimum wage. In 1999 until the first part of 2001 sustained low unemployment kept low-wage earners' wages rising despite the lack of a minimum wage increase.

Figure 3. The Minimum Wage vs. Low-wage Earners' Wage, PA (2004 dollars)



Source: KRC and EPI based on the CPS.

Who Would Be Affected?

The first question the Minimum Wage Advisory Commission has been asked to address is what are the characteristics of the Pennsylvania workers affected by an increase in the minimum wage. Table 2 answers this question for a minimum wage increase to \$7.15 per hour. Directly affected workers are those earning less than \$7.15 per hour. Indirectly affected workers are defined as those whose wages are within \$1 per hour of a \$7.15 per hour minimum wage. Past experience with minimum wage increases indicates that this group would enjoy a "spillover" increase that maintains some of their pay gap with workers at the new minimum.

Table 2 shows that 510,000 workers would benefit directly and another 350,000 indirectly. With regard to the characteristics of those directly affected, they would be

- nearly two thirds female
- 71 percent aged 20 and over (i.e., not teenagers)
- drawn heavily from low-wage service industries (including retail and hospitality) and occupations (and very little from manufacturing)
- about 22 percent from rural areas
- 80 percent white
- 12 percent African American (while only 8 percent of all Pennsylvania workers are African American)
- 5 percent Hispanic (while only 4 percent of all Pennsylvania workers are Hispanic).

Roughly a quarter of African-American and Hispanic workers would benefit directly or indirectly:

Table 2. Characteristics of Pennsylvania Workers Affected By A Minimum Wage Increase to \$7.15				
		Affected directly	Other low-wage workers*	All Workers**
Number of workers (in thousands)		510	350	5,285
Percent of all workers		9.7%	6.6%	100.0%
Gender				
	Male	34.8%	46.6%	50.7%
	Female	65.2%	53.4%	49.3%
Race / ethnicity				
	White	80.4%	80.1%	85.8%
	Black or Hispanic	17.4%	17.3%	11.9%
Age				
	16-19	28.9%	14.2%	4.9%
	20 and older	71.1%	85.9%	95.1%
	20 to 64	63.9%	80.4%	91.6%
	65 and older	7.2%	5.5%	0.4%
Work hours				
	1-19 hours	28.6%	16.8%	7.6%
	20-34 hours	34.3%	28.2%	12.6%
	Full-time (35+ hrs.)	37.1%	55.1%	79.9%
Industry				
	Retail trade	27.1%	24.4%	11.0%
	Leisure and hospitality	23.2%	15%	7.4%
Occupation				
	Sales	23.4%	20.2%	9.7%
	Service	36.4%	32.9%	15.3%
Metropolitan Status				
	Urban	77.7%	79.8%	81.2%
	Rural	22.3%	20.2%	18.8%
*Those earning within \$1.00 above the proposed minimum wage.				
**Includes workers not covered by minimum wage.				
Source: EPI analysis of 2004 CPS data.				

We can also characterize those affected by household income. Some critics have charged that a higher minimum wage is poorly targeted and goes substantially to affluent teenagers. *SWP2005* shows that

- nearly a third of the benefits of a higher minimum wage would go to the poorest fifth of Pennsylvania households;

- The poorest quintile's share of the benefits from a higher minimum wage is six times greater than its overall share of household income (shown in the third column of Table 4.)
- Another 31 percent of the benefits of a higher minimum wage would go to the second poorest fifth of households or to the middle fifth of households.

On average, furthermore, workers benefiting from a minimum wage increase earn 44 percent of their family income.

Table 3 takes another look at affected workers, listing groups of occupations that account for 24,000 or more workers. The table underscores the importance of the work performed by minimum wage workers and the fact that the rest of Pennsylvanians depends on these workers.

Affected workers include

- 165,000 cashiers and retail sales workers
- 125,000 people who prepare or serve food or wash the dishes in the commonwealth's eating and drinking establishments
- Over 90,000 clerical and administrative staff, from customer service representatives to receptionists, clerks and secretaries
- 60,000 who care for the most vulnerable Pennsylvanians who are young, old, or sick -- child care workers, preschool teachers, nursing aides, home health aides, and medical assistants
- Nearly 50,000 people who clean our offices and hotel rooms, houses and cars
- Another 50,000 who help distribute goods through our economy and drive our children to school,
- And a final 30,000 who take care of grounds and work in agriculture.

Occupations	Number of Workers	Share of All Workers by a Minimum Wage Increase
Cashiers, retail salespersons and supervisors, counter and rental clerks	164,744	19%
Cooks, other food preparers, waiters, waitresses, and dishwashers	124,345	14%
Clerical, incl. stock clerks, CSRs, receptionists, other clerks, and secretaries	92,955	11%
Early childhood and elder care workers and medical assistants	60,932	7%
Janitors, maids, housekeepers and vehicle cleaners.	46,140	5%
Grounds and agricultural workers	30,657	4%

Truck, sales, and bus drivers	28,130	3%
Laborers and freight, stock, and material movers, hand	24,936	3%
Source: KRC based on the CPS.		

The potential direct and indirect cost to employers

The Minimum Wage Advisory Commission has been asked to address the potential costs of a minimum wage to employers. It is worth noting that there are also potential benefits for some employers, such as lower workforce turnover, increased consumer demand, and increased market share (because no longer undercut my employers that pay very low wages).

To employers overall, the impact on labor costs of a \$7.15 per hour minimum wage will be small. This is partly because the 16 percent of workers directly and indirectly affected by the minimum wage hike account for a small part of total wages, an even smaller share of total compensation, and a still smaller share of total costs and total sales.

Two estimates in the research literature give an indication of how modest the impact of minimum wage increases on employers' wage bill tends to be:

- A 2002 study estimated that a proposed federal minimum wage hike from \$5.15 to \$6.65 by 2004 would increase employers' total wage bill by less than one tenth of one percent.¹
- A 2004 study estimated that Florida's proposed minimum wage increase to \$6.15 per hour would increase costs by 1/25th of one percent of total sales. Even for the most highly affected industry, costs were projected to increase by 0.69 percent of total sales.²

A second way to gauge the impact on employers is by considering the impact on total employment from past increases in federal and state minimum wages. If employment declines, this may indicate that employers could no longer afford to retain all their workers. (The rest of this sub-section is different from the *SWP2005* text.)

¹By seven one hundredths of one percent to be precise. See Jared Bernstein and Jeff Chapman, "Time to Repair the Wage Floor: Raising the Minimum Wage to \$6.65 Will Prevent Further Erosion of Its Value," Economic Policy Institute Briefing Paper #180, May 22, 2002.

² Robert Pollin, Mark Brenner, and Jeannette Wicks-Lim, *Economic Analysis of the Florida Minimum Wage Proposal* (Washington, D.C.: Center for American Progress and Amherst, MA.: Political Economy Research Institute, September 2004), p. 28.

Before diving into specifics from the recent research literature on the job loss issue, it is worth setting the context for the discussion by remembering some economic history.

One part of that history is the economic situation when the United States first enacted a federal minimum wage – in the 1938 Fair Labor Standards Act. This was during the Depression, a period of very high unemployment. If the minimum wage costs jobs it is puzzling in the extreme that it was enacted at a time of very high unemployment. In fact, however, when the minimum wage was enacted it was understood as one of several tools for increasing consumer demand and *reducing* unemployment. The view at that time was that lack of purchasing power among working families was an underlying cause of the Depression. As well as increasing fairness in the economy, raising the minimum wage (along with enacting Unemployment Insurance, establishing Social Security, and making it easier to form labor unions) was seen as a way to pump up consumer demand. With some help from the demand stimulation of World War II these policies worked for four decades.

A second piece of history relates to the years from the late 1940s to late 1960s when the minimum wage increased most rapidly in inflation-adjusted terms (see Figure 2 above). If the minimum wage causes unemployment you might expect these to have been years of high unemployment. In fact, they were not. They were years of very low unemployment.

This historical perspective makes clear that a higher minimum wage and even a minimum wage that rises rapidly in inflation-adjusted terms is not incompatible with rapid job growth and low unemployment.

Turning to the recent research literature, it is worth noting why this literature is so substantial. The reason is that the federal government has since the late 1970s only occasionally raised the minimum wage. Increasingly, therefore, states have taken action.

When states raise their minimum wage above the federal level it creates “natural experiments” that allow researchers to compare job trends in a state after it raises its minimum wage with trends in other states and the nation. (Federal minimum wage hikes can also be examined to see if they lead to slower job growth in states that had not previously raised their minimum wage above the prior level.)

Because of these natural experiments, the debate about the minimum wage and jobs is no longer a case of “he said, she said,” or one in which policymakers need to be satisfied by anecdotes from individual low-wage employers or business lobbyists. We can look at what actually happened.

In case after case, no significant loss of jobs took place.³

- After New Jersey raised its minimum wage in the early 1990s, to take one famous example, no difference was observed in employment growth in fast food restaurants as compared with neighboring Pennsylvania. (The Princeton authors of this New Jersey analysis have also conducted a wide range of related studies in their book on the “new economics of the minimum wage.”⁴)
- A recent Fiscal Policy Institute study of state minimum wages found no evidence of negative employment effects.⁵
 - In 12 states plus the District of Columbia in which the state (or city) minimum wage exceeded the federal level, employment growth was 50 percent greater from January 1998 to January 2004 (6.2 percent versus 4.1 percent) than in the other states where the federal minimum wage prevailed.
 - In the same period, retail employment grew by 6.1 percent in the high minimum wage states versus 1.9 percent in other states.
 - In high minimum wage states, the number of small businesses with fewer than 50 workers grew by 3.1 percent versus an increase of 1.6 percent for the balance of states.
 - In retail, the number of establishments, workers, and average payroll all grew faster in the higher minimum wage states.
- State minimum wages had no significant impact on state job growth from 2000-2003, according to a recent study by the Economic Policy Institute.⁶
- A 1998 Economic Policy Institute study found no significant job loss associated with the 1996-97 federal minimum wage increase.⁷

³ Economic Policy Institute, “Minimum Wage Facts at a Glance”; Jeff Chapman, “Employment and the Minimum Wage: Evidence from Recent State Labor Market Trends,” Briefing Paper #150, Economic Policy Institute, Washington, DC, May 2004.

⁴ David Card and Alan Krueger, “Minimum Wages and Employment: A Case Study of the Fast-Food Industry in New Jersey and Pennsylvania: Reply,” *The American Economic Review*, Vol. 90, Number 5, December 2000, pp. 1397-1420. See also, in general, David Card and Alan Krueger, *Myth and Measurement: The New Economics of the Minimum Wage* (Princeton: Princeton University Press, 1995).

⁵ Fiscal Policy Institute, *State Minimum Wages and Employment in Small Business*, April 20, 2004, online at www.fiscalpolicy.org.

⁶ Jeff Chapman, *Employment and the Minimum Wage: Evidence from Recent State Labor Market Trends*, Economic Policy Institute Briefing Paper #150, May 11, 2004, online at www.epinet.org.

- The low-wage labor market, in particular, performed better following the 1996-97 increase in the minimum wage than it had in decades, as evidenced by lower unemployment rates, increased average hourly wages, increased family income and decreased poverty rates.

A higher minimum wage does not lead to job loss for several reasons. One reason is that many low-wage employers have large numbers of unfilled positions. A higher minimum wage reduces this number because workers leave their job less often and because openings can be filled more quickly. As noted earlier, a higher minimum wage can also create jobs because it increases consumer demand among low-wage workers. A Florida study estimated that retail businesses in low-income neighborhoods in Miami would experience a sales increase of about 3 percent from a minimum wage hike to \$6.15 per hour.⁸

A final reason a higher minimum wage does not lead to job loss has already been noted. It makes only a small difference to business costs.

New research on the minimum wage has swayed a substantial part of the economics profession over the past decade towards support for a higher minimum wage. In a statement released by the Economic Policy Institute, more than 500 economists nationally, including three Nobel Prize-winners and four past presidents of the American Economic Association, agreed that "increases in state minimum wages in the range of \$1.00 to \$2.00 can significantly improve the lives of low-income workers and their families, without the adverse effects that critics have claimed." This June, the Keystone Research Center released a similar statement signed by 43 economists (from many of the commonwealth's most eminent institutions of higher education) supporting an increase in the Pennsylvania minimum wage. (The statement signed by the Pennsylvania economists is on line at www.paminimumwage.com/econstatement.htm.)

A minimum wage would have particularly small impacts on Pennsylvania employers in competition with other states and nations. This is partly because the states closest to the most populous parts of Pennsylvania – Delaware, New Jersey, and New York – already have passed a higher minimum wage. It is also

⁷ Jared Bernstein and John Schmitt, *Making Work Pay: The Impact of the 1996-97 Minimum Wage Increase*, 1998, online at www.epinet.org. For some Pennsylvania specifics, see also Keystone Research Center, *Making Work Pay: The Benefits of the 1996-97 Minimum Wage Increase for Low-wage Workers in the U.S. and Pennsylvania*, online at www.paminimumwage.com.

⁸ Pollin et. al., *Economic Analysis of the Florida Minimum Wage Proposal*.

because manufacturing and other industries vulnerable to relocation already pay above \$7.15 and \$8.15 for the most part.

- Only 3 percent of Pennsylvania manufacturing workers earn between \$5.15 and \$7.15 per hour and another 3 percent earn between \$7.15 and \$8.15 per hour,
- In the information, financial activities, and professional and business services industries, the percentages of workers who earn between \$5.15 and \$7.15 per hour are also low (6 percent in information, 5 percent in financial activities, 7 percent in professional and business services, compared to 10 percent the workforce as a whole).

Of course, some individual employers may lose with a higher minimum wage just as others will gain. Businesses are destroyed every day in response to oil price fluctuations, new technologies, and changing consumer tastes. This process of creative destruction lies at the heart of our market economy: firms adapt to changing market conditions or they die.

A minimum wage is a threat to employers who fail to use their workers as productively as their competitors. More productive employers will absorb their demand. That is a good thing.

The maintenance of a high standard of living in Pennsylvania depends on our capacity to create and nurture innovative and agile entrepreneurs that combine high profits with good jobs. A higher minimum wage is an important tool for rewarding productive employers and preventing them from being undercut by competitors whose strategies are incompatible with worker, family, and community well-being.

The effect of minimum wages above the Federal level in other jurisdictions

Recent studies evaluating the impact of higher minimum wages in other states are summarized in the previous section.

Towards A Moral Economy

The debate about the minimum wage speaks to a more general question: will the state's economy undercut or uphold Pennsylvania values, including the value that people who work hard should earn a decent wage?

Polls show that there is overwhelming support in Pennsylvania and in other states for increasing the state minimum wage because it resonates with people's sense of basic fairness. This resonance extends to the many families who will not benefit directly. In November 2004, for example, Florida voters approved, 71 percent to 29 percent, a measure to increase the state minimum wage. A majority of voters in every county favored the proposal. At the

same time, Nevada voters approved, 68 percent to 32 percent, a measure to increase the state minimum wage. A majority of voters in every county favored the proposal.

The popular, values-based consensus for a higher minimum wage leaves only one possible non-ideological reason for opposing such a change: that it would have strong negative effects. The research summarized above shows that a higher minimum would not have negative economic effects. Opponents of a hike may continue to shed crocodile tears, claiming that a higher minimum wage will hurt those it is supposed to help. Actual experience with federal and state minimum wage increases shows that it would not.

There are, moreover, affirmative economic reasons to support a higher minimum wage – reasons more widely recognized when states and the nation first passed a higher minimum wage but no less relevant for their invisibility today. The first reason, alluded to earlier, is that a higher minimum wage can help induce more rapid adoption of higher productivity competitive strategies. This was one of its goals 100 years ago when it was used in the battle to eliminate unproductive piece-rate apparel sweatshops.⁹ Although the composition of the economy and the types of employers most affected may differ today, the need to encourage employers to adopt higher-wage, higher-skill strategies remains.

A second affirmative reason is that the minimum wage can help maintain purchasing power when it lags behind the productive potential of the economy. As discussed, lagging purchasing power was a critical problem in the 1930s when the federal government used a new minimum wage – and other policies -- to help create consumer demand that would bring the economy out of the Great Depression. Maintaining the purchasing power of middle- and lower-wage workers has become a problem once again, not only in Pennsylvania and the United States but globally.

In sum, raising the Pennsylvania minimum wage

- is the right thing to do
- would not lead to significant job loss
- is good economics, contributing to productivity growth and sustaining consumer demand.

Raising the minimum wage and then indexing it to inflation (as with legislative pay) is a common sense approach to achieving an economy more aligned with our values and that is more productive – a moral economy.

⁹ Michael J. Piore, "Labor Standards and Business Standards," in *Labor Standards and Development in the Global Economy* (Washington, D.C.: Bureau of International Labor Affairs, U.S. Department of Labor, 2000).