# Making Work Pay:

## The Benefits of the 1996-97 Minimum Wage Increase for Low-Wage Workers in the US and Pennsylvania

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## Executive Summary

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On October 1, 1996, the federal minimum wage rose from $4.25 to $4.75. It increased to $5.15 on September 1, 1997. In a recent national study, *Making Work Pay: The Impact of the 1996-97 Minimum Wage Increase*, Jared Bernstein and John Schmitt of the Economic Policy Institute (EPI) in Washington, D.C., examined how these increases affected low-wage workers.[1] Building on the EPI analysis, the Keystone Research Center (KRC) here examines the impacts of the minimum-wage increases on low-wage workers in Pennsylvania.

### *The Impact Across the U.S.*

With respect to income gains among low-wage workers, EPI found that:

- Almost 10 million workers benefited from the minimum wage increases. About 71 percent of these were adults and 58 percent were women.

- The two-stage increase disproportionately benefited low-income working households. The poorest 20 percent of working households in the United States together receive only 5 percent of all household income. However, they received 35 percent of the gains from the minimum wage increase. Further, the average minimum-wage worker contributes more than half (54 percent) of his or her household's weekly earnings.

- Contradicting the predictions of many economists, no widespread or significant job loss resulted from the 1996-97 minimum wage increases. The EPI study used four different methods to estimate the employment impact of the increases. Those job losses that were detected were small and statistically insignificant.

### *The Impact on Pennsylvania*

Slightly more than 437,000 Pennsylvania workers, 8.9 percent of the state's total, benefited directly from the minimum wage increases. This compares to (the same) 8.9 percent of workers who benefited nationally and to 7.3 percent of workers in the six states surrounding Pennsylvania.

In 1997, following the second of the two minimum wage increases, the inflation-adjusted wages of Pennsylvania low-wage workers increased by 2.5 percent, from $6.76 to $6.93 an hour.[2] This was the first meaningful increase in the earnings of low-wage Pennsylvania workers since 1990, not coincidentally the beginning of the last two-stage federal minimum wage increase.

The increase in earnings for lower-wage workers did not come at the expense of low-wage job opportunities. In 21 months following the 1996 minimum wage hike (a period that included the 1997 increase), job growth at the aggregate level and in two wage-sensitive industry divisions (retail trade and a group of services that includes business and personal services) was similar to or higher than in the previous 21 months.

### *Conclusion*

In sum, the minimum wage is an effective tool for raising the earnings of low-wage workers without lowering their employment opportunities. An added benefit of minimum wage increases is their ability to spur lower-wage employers to focus more attention on improving productivity and quality.

In light of the benefits, Pennsylvania should follow the lead of six other states and raise its minimum wage above the federal level.

# Introduction

One of the most troubling economic phenomena of the past two decades has been the sharp decline in the inflation-adjusted wages of low-wage workers. The real hourly wage of workers near the bottom of the wage scale (at the 10th percentile of the earnings distribution) clearly reflects this trend. Their wages fell 15 percent between 1979 and 1997 in the United States as a whole. Since many low-wage workers are major contributors to their families' incomes, this decline has played an important role in the rise in family income inequality documented in an earlier Keystone Research Center briefing paper ("Pulling Apart in Pennsylvania: The Incomes of Pennsylvania Families Since the 1970s.")

Over most of the 1979-97 period, the real value of the minimum wage also fell precipitously — even while productivity and the overall size of the economic pie continued to rise (see Figure 1). Comparing today's situation with as far back as 1968, *the minimum wage has lost more than half its value relative to productivity*. If the minimum wage had kept pace with productivity since 1968, as Figure 1 shows that it did in the decades before that, it would now be over $10.00 per hour.

The declining real value of the minimum wage in the 1980s, and the falling living standards of low-income households even during periods of overall economic growth, led policymakers in the 1990s to raise the wage floor. Congress enacted two separate 90 cent increases, each in two steps over a two-year period. The first took place over the period 1990-91, raising the minimum wage from $3.35 to $4.25; the second increase, from $4.25 to $5.15, was implemented in 1996-97.

As Figure 1 shows, *the minimum wage increases in the 1990s have made up only a small fraction of the drop in the real minimum wage in the 1980s*. The 1996-97 increases have simply brought the minimum wage back to roughly its real value after the 1990-91 increases.

## Minimum-Wage Increases: Who Benefits?

Proposals to raise the minimum wage always generate heated debate. On one side, opponents claim that making low-wage workers more expensive is likely to cost many of those workers their jobs. Opponents also argue that much of the benefit of higher incomes for low-wage workers flows to the teenaged children of middle and upper-middle income families. On the other side, proponents argue that the minimum wage has always been key to raising the earnings of low-wage workers. They claim that there is little evidence that increases unduly benefit those who do not need a raise. Proponents say, finally, that a higher minimum wage can induce low-wage employers to search more systematically for ways of improving quality and productivity. Below we tackle each of these issues, first examining the impact on workers' incomes.

### *Income Effects Nationally*

EPI found that almost 10 million workers nationally benefited directly from the minimum wage increases. (In the year before the October 1996 increase, these 10 million workers had incomes between $4.25, the old minimum wage, and $5.15, the current one). While opponents of a higher minimum wage have suggested that most of these beneficiaries are teenagers in relatively high-income households, the findings in the EPI report contradict this characterization:

- The average minimum-wage worker brings home more than half (54 percent) of his or her family's weekly earnings.
- Most workers who benefited from the increased minimum wage were adults aged 20 or over (71 percent). More than half (58 percent) were female.
- Nearly half (46 percent) of those who benefited worked full-time and another third worked 20-34 hours a week.

At the same time, the EPI study showed that the policy is far from perfectly targeted. For example, about one-quarter of the benefits from the increase did go to working households in the top 40 percent of the income scale. But the benefits of the raises disproportionately helped households at the bottom of the income scale. Although households in the bottom 20 percent (whose average income was $15,728 in 1996) received only 5 percent of the total national income, they took home 35 percent of the benefits from the minimum wage increase.

The EPI results suggest that the 1996-97 increases achieved their intended effect. They raised the earnings and incomes of low-wage workers and their families. Most of the benefits went to those who needed them most.

### *Income Effects in Pennsylvania*

In Pennsylvania as in the United States, 8.9 percent of the workforce — 437,000 workers — benefited directly from the minimum wage increase.

For this group of nearly half a million Pennsylvania workers, the minimum wage increase helped reverse a decline in earnings that continued into the mid-1990s despite aggregate economic growth. From 1990 to 1995, the last full calendar year before the 1996-97 minimum wage raises, hourly earnings of low-wage Pennsylvania workers fell from $7.13 to $6.74 (in 1997 dollars). From 1995 to 1996, when the minimum wage increased only in the last quarter of the year, Pennsylvania low-wage workers' earnings remained essentially unchanged. In 1997, low-wage workers' earnings rose 2.5 percent, from $6.76 to $6.93.

### *Employment Effects Nationally*

Do minimum wage raises produce job losses? Economists have developed a battery of ways to measure the effects of minimum wage increases on employment. Many of these approaches have been applied to earlier increases in the minimum wage, but prior to the EPI report, there had been no careful analysis of whether employment declined as a result of the 1996-97 minimum wage increases.

EPI used four different methods to assess the employment impact of the most recent increases.[4] Given that the second stage of the two-phase increase was just implemented on September 1, 1997, it is reasonable to ask whether enough time has elapsed for employment effects to be felt. However, EPI researchers had 17 months of data since the first increase and six months of data following the second increase. They compared employment changes over these months to employment changes during 18 or more months prior to the first increase. If employers were adjusting the size of their workforce in response to minimum wage increases, there is no good reason to believe that they would wait more than 17 months to put in place even the first of these adjustments. In addition, EPI searched for impacts on employment from each minimum wage increase separately and from the two increases together.

At the national level, EPI found little or no job loss from the 1996-97 minimum wage increase. In particular:

- None of the four methods used indicated widespread job loss.

- The measured effect on employment was generally not statistically significant. Any impacts, either in the aggregate or for different demographic groups, were nearly as likely to be positive as negative and varied unsystematically.

- One of the methods showed employment rates of the most affected groups (teenagers and adults without a high-school education) *rising* after the increases in the minimum wage.

### *Employment Effects in Pennsylvania*

The Keystone Research Center did not perform the same statistical procedures for Pennsylvania that EPI used to evaluate employment impacts nationally. But even a cursory glance at employment trends in Pennsylvania during the relevant time periods places the burden of proof on the shoulders of those who believe that minimum wage increases hurt low-income workers. Table 1 tells the Pennsylvania employment story.

**Table 1**
**Pennsylvania Employment Growth (percent) in 21-month Periods**
**Before and After the October 1996 Federal Minimum Wage Increase**

| Time Period | Non-Agricultural Employment Growth | | Services* |
|---|---|---|---|
| | Employment Growth | Retail Trade | Employment Growth |
| Jan 95- Sept 96 | 1.5 | 5.0 | 1.8 |
| Sept 96- May 98 | 2.6 | 4.5 | 2.0 |

*This category includes personal and business services, and hotels, as well as health services and some other professional services.

Source: Current Employment Statistics Program, Bureau of Labor Statistics, U.S. Department of Labor

Comparing the 21 months prior to the October 1996 minimum wage increase with the next 21 months (a period that included the September 1997 increase), there was no slowdown in job creation. For total non-farm employment as well as in two wage-sensitive industry divisions (retail trade and a group of services that includes personal and business services), Pennsylvania's employment growth rates were similar or higher in the period after the minimum wage increases than they were in the period before the increases.

# Explaining the Results

According to the simplistic "competitive" economic model, if the price of a commodity rises, demand for that commodity will fall. Many economists believe that this principle applies to labor as well; if the price of labor goes up, employers' demand for workers will decline. If this were true, then minimum wage increases would reduce employment. Experience, however, often contradicts the predictions of the standard model.[3] EPI's new findings about the impact of the recent minimum wage increases are just the latest contribution to a growing body of evidence at odds with the conventional view.

Opponents of minimum wage increases might offer several explanations for why the 1996-97 minimum wage increases were almost as likely to produce employment gains as employment losses:

- First, employment declines may not be felt immediately. Employers cannot adjust their production processes overnight, but in time they will find ways to trim jobs. But most people who earn near the minimum wage work in high-turnover service sector jobs. The six-to-17 month time frame examined by EPI should have been ample time for service sector employers to make employment adjustments.

- Second, employers may have compensated for the minimum wage increase by reducing the number of hours each employee works, without eliminating jobs. Even if this were always true (which is not likely), it would surely be a desirable consequence of the minimum wage increase. Low-wage earners would be putting in fewer hours for the same pay.

- Third, healthy overall demand for goods and services might have enabled the number of low-wage jobs to stay the same, or even rise, even though the number would have been even higher without the minimum wage increases. EPI, however, used various methods to take into account overall demand. The lack of job loss observed does not seem to be the consequence of a booming economy.

In light of the evidence, EPI suggests that the low-wage labor market does not operate like a simple competitive market.[2] Employers do not just act passively to wages set by the market, demanding more workers when wages are high and fewer when wages are low. Even low-wage employers have some control over the wages that they pay. Some low-wage employers use this control to set wages very low. For this reason they sometimes have trouble holding onto workers or filling job openings when workers quit.

Recognizing that low-wage employers have turnover and recruitment problems suggests a common-sense explanation for why a minimum wage hike might even raise employment at some firms (and have small effects overall). When it forces low-wage employers to raise wages, a higher minimum wage may lower their turnover rate and make it easier for them to recruit new workers. As a result, some employers may have fewer unfilled job openings and *more* workers on the payroll *after* a minimum wage increase.

## The Minimum Wage and Productivity

Even if the standard competitive model is wrong, raising the minimum wage above a certain range may reduce employment. Despite this, there may be good reasons to raise the minimum wage substantially — for example, bringing it towards the over-$10 level that it would now have reached if it had kept pace with productivity since 1968.

Why would a large increase in the minimum wage make economic sense? Because the minimum wage is a critical instrument for promoting improvements in economic performance. (Should job loss result, a wide range of public policies could be used to compensate: tax cuts, more government spending, and direct government job creation to name but a few.)

Research shows that many low-wage employers today do not systematically attempt to improve productivity, quality, or service. In a long list of industries, some employers keep wages and benefits low while leaving workers largely to their own devices to figure out how to perform their "low skill" jobs. Examples can be found in industries as diverse as long-distance trucking and nursing homes, telemarketing and hotel housekeeping, data-entry piece-work and classic apparel sweatshops, child care and retail trade.[3]

In the decades after the 1938 passage of the federal Fair Labor Standards Act, policymakers and the public understood the role of the minimum wage in discouraging "sweating" competitive strategies in which profit derives largely from keeping wages and benefits low. By having the minimum wage track the nation's rising productivity growth rate, Congress helped sustain efforts to improve performance among lower-wage employers. All Americans benefited when this resulted in higher living standards. It is time to remember again the key role of the minimum wage in sustaining pressure for performance gains.

## Conclusion

Even though there have been two long periods of sustained economic growth in the United States and Pennsylvania during the last two decades, low-wage workers have been left behind. During the 1980s, this problem was largely due to the nine-year decline in the real value of the minimum wage. Congress has acted to reverse this decline by raising the minimum twice in the 1990s. These increases led to heated debates over whether they would achieve their intended goal of lifting the incomes of low-wage workers and their families. In its review of the 1996-97 increase, EPI found that the policy is working: the increase has raised the earnings of low-wage workers without leading to significant job losses.

From its review of data on Pennsylvania, Keystone Research Center has arrived at the same conclusion: the benefits of minimum-wage hikes have clearly outweighed the costs, if any, to low-wage workers in Pennsylvania.

In light of the evidence, Pennsylvania should join the six other states that have increased their state-level minimum wage above the federal level. Some Pennsylvanians may worry that this would reduce the flow of investment to the state. This seems unlikely because most jobs paying near the minimum wage are in retail trade and other service industries that have no choice but to locate near their Pennsylvania customers. Even so, to accommodate those with concerns about competition for investment — and so that this concern cannot be used as an excuse for taking no action — Pennsylvania legislators could condition a state minimum wage increase on increases in three or more of the six surrounding states.

[1] Copies of the EPI report may be obtained from EPI Communications Director Nan Gibson at (202) 331-5546.

[2] Unless otherwise specified, "low-wage workers" in this paper means workers at the 20th percentile of the earnings distribution (who earn wages greater than or equal to 20 percent of all workers and less than 80 percent of all workers). Data for 20th percentile workers in Pennsylvania over time provided to KRC by David Webster of EPI.

[4] Details of this analysis, along with data sources and an explanation of the statistical methods employed, are presented in the EPI report

[3] For a summary of the evidence through 1995, see David Card and Alan Krueger, *Myth and Measurement: The New Economics of the Minimum Wage* (Princeton: Princeton University Press, 1995).

[2] For more details on the non-competitive model of the labor market that EPI suggests is consistent with the evidence, see Jared Bernstein and John Schmitt, *Making Work Pay: The Impact of the 1996-97 Minimum Wage Increase* (Washington, D.C.: Economic Policy Institute, 1998), pp. 39-42.

[3] For case examples and an extended discussion of why employers do not attempt to improve performance in a group of jobs that now accounts for roughly a quarter of employment, see Stephen A. Herzenberg, John A. Alic, and Howard Wial, *New Rules for a New Economy: Employment and Opportunity in Postindustrial America*, a Twentieth Century Fund Book (Ithaca: Cornell/ILR Press, 1998), especially chapters 3 and 4.