Do minimum wage increases reduce poverty? An American perspective

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Abstract

Based on 70 years of American experience since the passage of the *Fair Labor Standards Act* 1938 (FLSA) (and the creation of the first federal minimum wage in the United States), we conclude that past minimum wage increases have not diminished poverty and current proposals to increase the federal minimum wage to $9.50 per hour will be even less targeted to the working poor. The majority of those who gain from a minimum wage increase do not live in poor or even near poor households. Furthermore, a large share of the working poor are not affected by such increases since they already earn wages above the proposed minimum. Finally, the negative employment effects of these minimum wage increases are sufficient to offset the movement out of poverty by those working poor who are helped by the policy. Preliminary evidence suggests that Australian minimum wage increases are no more effective at reducing poverty for the same reasons.

A far more effective method of achieving the goal of assuring that those who work hard and play by the rules are not poor is via an increase in the Earned Income Tax Credit (EITC). This work-based program targets benefits based on family income rather than on a single person's hourly wage rate. And, unlike the minimum wage, the EITC has a positive effect on employment.

1. Introduction

> The minimum wage provisions of the FLSA have been repealed by inflation. Many voices are now taking up the cry for a higher minimum, say of 60 to 75 cent per hour. 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?, and (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 unimportant; the arguments on which they rest are … (Stigler, 1946, p. 358)

While the level of the minimum wage proposed is certainly different, this introduction to the first modern economic evaluation of the employment and poverty reduction effects of minimum wage laws could well have been written about calls for increases in the current American and Australian minimum wages. Equally as current is the challenge Stigler gives us to ignore ideological shibboleths and focus on the evidence with respect to the success

The views in this paper do not necessarily reflect those of the Australian Fair Pay Commission. Burkhauser completed this paper while he was the R.I. Downing Fellow in Social Economics in the Faculty of Economics and Commerce, University of Melbourne.

of minimum wage increases in diminishing poverty both absolutely and relative to alternative policies. For those interested in providing more than symbolic help to the working poor, this is the test for any future minimum wage increase.

In Stigler's 1946 paper, this future Nobel Prize economist lays out what have become the principal arguments against minimum wage increases. The first argument addresses the behavioural response to a minimum wage increase. A government mandated price floor that effectively keeps the price above the competitive market clearing price will cause a surplus. Because the hourly wage rate is the price employers pay for labour, an increase in the minimum wage will increase the pay of those workers who keep their jobs at the expense of the low-skill workers who will lose them. The number of lost jobs will depend on the sensitivity of employers to a price increase – their elasticity of demand. Thus, while minimum wage increases will help some households to escape poverty because low-skilled workers who keep their jobs will receive higher labour earnings, this effect will be offset by other households who fall into poverty because previously employed workers lose their jobs or have their work hours significantly cut.

But Stigler also made a second and less well understood point. Redistributing income via price floors is not efficient. Just as an increase in the price floor on cotton will indiscriminately benefit poor, small-scale cotton farmers and non-poor, large corporate farmers at the expense of consumers, an increase in the minimum wage will indiscriminately benefit workers who live in poor and non-poor households at the expense of consumers. The effectiveness of minimum wage increases as an anti-poverty device will diminish as the relationship between a worker's wage rate and his or her household's income becomes weaker. Thus, even if we ignore negative employment effects, minimum wage hikes will be increasingly ineffective at reducing poverty as (i) the share of poor workers who earn wages above proposed minimums rises, and (ii) the share of minimum wage workers who live in non-poor households increases.

Stigler's arguments were powerful in 1946, but his evidence was weak. Based on our reading of the current evidence, we argue that minimum wage increases may have been the most effective means of helping the working poor in 1938. But given policy alternatives available in the United States (US) in 2008, further minimum wage increases will do little to reduce poverty and are a poor substitute for further expansions in the EITC program as a mechanism for reducing poverty.

We conclude with a discussion of the implications of the American experience for the Australian Fair Pay Commission as it considers its answers to Stigler's questions – (1) Do its mandated minimum wage polices diminish poverty?, and (2) Are there efficient alternatives?

2. A brief history of the United States minimum wage

Social reformers of the late 19th and early 20th century confronted by an emerging capitalist system saw direct government regulation of labour markets as the best means of ensuring a living wage for all (Ryan, 1906). In an era without state or federal income taxes (and hence small revenue bases), without labour unions, and with few government programs to provide income assistance for the working poor, early state minimum wage and hours laws sought to ensure a minimum income for the households of all workers via regulatory boards of 'social partners' (government, labour, and management). The laws were intended to directly intervene in the marketplace by establishing a set of 'just' wage rates. But most such efforts by state legislatures in the US in the early 20th century were ruled unconstitutional.

Franklin Roosevelt's impassioned speech calling on Congress to help the one-third of Americans who were 'ill-housed, ill-clad, and ill-nourished' heralded the FLSA, and with it, the first federal minimum wage for US workers (Roosevelt, 1937). This Act marked the culmination of a long struggle to establish that state and federal legislatures could regulate the 'freedom to contract' in the marketplace, found in the 14th Amendment of the US Constitution. But the FLSA steered clear of the 'corporate state' type of regulatory boards that still exist in some European countries as well as in Australia in the form of the Australian Fair Pay Commission. Instead, the FLSA simply set one national minimum wage that applied to all states and could be raised as appropriate by Congress. Each state was then free to increase its own minimum wage law above the federal minimum hourly wage.

Proposals to increase the minimum wage remain politically popular in the US because they continue to be widely seen as an effective way to help the working poor (AP-AOL, 2006). President Clinton captured this majority view in his statement of support for an increase in the Federal minimum wage when he said: 'It's time to honor and reward people who work hard and play by the rules … No one who works full time and has children should be poor anymore', (Clinton and Gore, 1992). The goal of helping the working poor was also an important motivation behind the most recent legislation to increase the federal minimum wage from $5.15 to $7.25 per hour in 2007, and was echoed by then US Senator and now President Barack Obama in his support of legislation to increase the Federal minimum wage from $7.25 to $9.50 per hour:

> Barack Obama believes that people who work full time should not live in poverty. Before the Democrats took back Congress, the minimum wage had not changed in 10 years. Even though the minimum wage will rise to $7.25 an hour by 2009, the minimum wage's real purchasing power will still be below what it was in 1968. As president, Obama will further raise the minimum wage to $9.50 an hour by 2011 … (BarackObama.com, 2008, p. 3)[1]

While we agree with Stigler that the elimination of extreme poverty is not seriously debatable, the evidence we discuss below suggests that despite their continued political popularity, minimum wage increases provide little more than symbolic support to the working poor. The reasons are those first provided by Stigler – the negative employment effects on low-skilled workers and the weak relationship between low wages and low household income.

3. Literature review

3.1 Employment effects of minimum wage increases

The vast majority of the empirical economics literature on the US minimum wage experience over the first 50 years following the passage of the FLSA focussed on the employment effects of minimum wage increases. Brown *et al.* (1982) review this literature and reflect the consensus view that the employment effects of relatively small increases (increases that do not put the minimum wage very high up the hourly wage rate distribution) in the minimum wage have a small, but significant negative effect (between 0.1 and 0.3 or a 1 to 3 per cent reduction in employment for every 10 per cent increase in the minimum wage) on the employment of low-skilled workers (such as teenagers and high school dropouts). Historically, minimum wage increases have not affected the vast majority of workers; thus,

1 The Obama minimum wage plan has support among a number of leading Democrats, including Sen. Edward M. Kennedy (Zappone, 2007), former Sen. John Edwards (Montanaro, 2007), and Sen. Hillary Clinton (Zappone, 2007), who introduced Senate legislation (S.2514, 'Standing with Minimum Wage Earners Act of 2007') in December 2007 to increase the Federal minimum wage to $9.50 per hour.

overall employment effects have been negligible, and effects on low-skilled groups have tended to be relatively small.

This consensus in the economics literature ended with Card and Krueger (1995) who fundamentally criticise this empirical literature, arguing that it provides little solid evidence of a negative employment effect for minimum wage increases of any size. In doing so, they featured several of their own studies using what was at the time a new way of capturing the effects of policy changes – natural experimentation. Their iconoclastic book caused a major reconsideration of the consequences of minimum wage increases in the economics literature and more generally popularised the use of natural experiments as a way of capturing the marginal effect of policy changes. Since 1995, a substantial number of new studies of the effect of state and federal minimum wage laws have been undertaken using more precise data and in some cases evaluating it using natural experiment techniques.

Neumark and Wascher (2007) review over 90 studies published since the early 1990s, some of which use natural experimental techniques and conclude that the evidence is 'overwhelming' that low-skilled workers experience significant disemployment effects of minimum wage increases (see, for example, Williams, 1993; Deere, Murphy and Welch, 1995; Currie and Fallick, 1996; Abowd *et al*., 1999; Baker *et al*., 1999; Partridge and Partridge, 1999; Burkhauser, Couch and Wittenburg, 2000a,b; Couch and Wittenburg, 2001; Neumark, 2001; Neumark and Wascher, 1992, 2002; Neumark *et al*., 2004, 2005; Campolieti *et al*., 2005; Campolieti *et al*., 2006; and Sabia, 2008a,b,c). In this context, the positive employment effects some studies find (see Card and Krueger, 1995) appear to be outliers. Our reading of Neumark and Wascher (2007, 2008) is that the preponderance of the new literature on the minimum wage returns us back to the pre-Card and Krueger (1995) view that relatively small increases in the minimum wage that do not impact the wage rates of most workers have small but significant and negative effects on the employment of low-skilled workers.

While most of these studies examine the employment effects of state minimum wage increases over the nation as a whole, far fewer have exploited natural experiments as recommended by Card and Krueger (1995) using case studies of particular states. In a new study (Sabia and Burkhauser, 2008a), we use data from the Current Population Survey (CPS) outgoing rotation groups and exploit a natural experiment to estimate the employment effects of recent New York State minimum wage increases. We estimate difference-in-difference and triple-difference models using border (Pennsylvania) and near-border states (Ohio and New Hampshire) that had not raised their minimum wages as cross-state controls, and more highly educated or experienced workers who should not be affected by minimum wages as within-state controls. We find that the 2005–2006 New York State minimum wage hike from $5.15 to $6.75 per hour reduced employment among 16-to-29 year olds without a high school degree by 18.0 to 43.1 per cent, an implied elasticity of –0.6 to –1.4, which is far higher than those found using nationwide data. We then use these employment elasticities, along with more conservative estimates from the literature (Neumark and Wascher, 2008), to simulate the employment and distributional consequences of a newly proposed New York State minimum wage hike from $7.15 to $8.25 per hour. Under conservative elasticity assumptions, we find that only 21 per cent of the benefits of this minimum wage hike would be received by workers in poor households. At employment elasticities greater than -0.89 in absolute magnitude, we estimate that net monthly benefits from this minimum wage hike will become negative.

3.2 Poverty effects of minimum wage increases

Several recent studies have examined the poverty effects of minimum wage increases (see, for example, Card and Krueger, 1995; Addison and Blackburn, 1999; Neumark and Wascher, 2002; Gundersen and Ziliak, 2004; and Burkhauser and Sabia, 2007, 2008a), and all but one have found that past minimum wage hikes had no effect on poverty.[2] These studies have generally taken one of two approaches. The first approach uses matched CPS data and examines family income changes caused by minimum wage increases (Neumark and Wascher, 2002; Neumark *et al*., 2004, 2005). These studies find that some low-skilled workers living in poor families who remain employed see their incomes rise and move out of poverty when the minimum wage increases. However, other low-skilled workers lose their jobs or have their hours substantially reduced as a result of minimum wage hikes, causing income losses and increased poverty. On net, Neumark and Wascher (2002) find that the families of low-skilled workers are made no better off and may be made worse off by minimum wage hikes. Sabia (2008a) finds a similar result for less-educated single mothers.

A second approach, taken by Card and Krueger (1995) and Burkhauser and Sabia (2007), estimates the effect of state minimum wage increases on state poverty rates. They also find no evidence that minimum wage increases significantly reduced poverty either among the families of all individuals or among the families of workers.

3.3 Simulations of who gains from minimum wage increases

A series of studies by Burkhauser and Finegan (1989), Burkhauser, Couch and Glenn (1996), Burkhauser and Harrison (1999), and Burkhauser and Sabia (2007) avoids the controversies surrounding the magnitude of employment and hours worked effects of past minimum wage increases and focussed on the second of Stigler's reasons for the ineffectiveness of minimum wage increases in reducing poverty – their poor target efficiency. These studies assume no behavioural effects of the minimum wage, giving proposed hikes their best chance to benefit affected workers. But even under the optimistic assumption of no employment or hours worked effects, the authors find that few benefits of past minimum wage increases were received by workers living in poor households, because most workers in these households already earned hourly wages that were greater than the proposed state or federal minimum wages, and that most workers who did gain were second- or third-earners living in households well above the poverty line. However, these simulations assume a zero employment demand elasticity and hence are upper-bound estimates of the benefits to workers. In our case study of New York State, discussed above (Sabia and Burkhauser, 2008a), we account for these adverse labour demand effects and find that workers in poor households receive an even smaller share of a shrinking pie of additional net wage earnings.

In what follows, we discuss some of the findings in our latest study, Sabia and Burkhauser (2008b), which updates the poverty estimates of Card and Krueger (1995) and Burkhauser and Sabia (2007) and extends our simulation study of the distributional effects from a New York State minimum wage increase (Sabia and Burkhauser, 2008a) to the entire nation. In this paper (Sabia and Burkhauser, 2008b), we focus on the effect of minimum wage increases on state poverty rates over the mid- to late-2000s, a period during which 28 states increased their minimum wages above the federal level, and the federal minimum

2 The one exception is Addison and Blackburn (1999), who find that minimum wage increases reduce poverty among junior high school dropouts. However, as Neumark and Wascher (2008) note in their forthcoming book, junior high school dropouts are older and unlikely to have small children, whereas most anti-poverty efforts focus on families with younger children.

wage rose from $5.15 to $5.85 per hour. We then simulate the distributional effects of the latest proposals to increase the federal minimum wage to $9.50 per hour.

4. Do minimum wage increases reduce poverty?

To examine the effect of past minimum wage increases on state poverty rates, in Sabia and Burkhauser (2008b), we pool data from the March 2004 through March 2008 CPS and estimate a fixed-effects model similar to Card and Krueger (1995) and Burkhauser and Sabia (2007). To be consistent with this poverty literature, we follow these authors and use the family unit to calculate poverty status, and estimate the following model:[3]

$$P_{st} = \alpha + \beta MW_{st} + \mathrm{X}'_{st}\delta + \theta_s + \tau_t + \varepsilon_{ist} \quad (1)$$

where P_{st} is the natural log of the poverty rate, as officially defined by the Office of Management and Budget, in state s at time t, MW_{st} is the natural log of the higher of the state or federal minimum wage, X_{st} is a vector of state-specific, time-varying socioeconomic controls including the unemployment rate for prime-age males aged 25–54, the average adult wage for working individuals aged 25–54, the share of older (aged 55 to 64) and younger (aged 16–24) individuals in the state population, a time-invariant state effect (θ_s) and a state-invariant time effect (τ_t). Family income is measured in the previous year, so the sample in the regression corresponds to calendar years 2003 to 2007. The key parameter of interest in this model is β_1. Thus, much of the identifying variation is coming from state minimum wage increases.[4]

Table 1, taken from Sabia and Burkhauser (2008b), provides fixed-effects estimates of the effect of recent minimum wage increases on state poverty rates among 16–64 year olds. Column (1), provides no evidence that minimum wage increases between 2003 and 2007 affected overall state poverty rates. While the sign on the estimate of β_1 is negative, the effect is not statistically different from zero and is, in fact, smaller than the estimate found by Burkhauser and Sabia (2007) over the years 1988–2003. When the sample is restricted to workers (column 2), which gives the minimum wage its best chance to reduce poverty by raising incomes of low-skilled workers, there is still no effect on poverty rates. In fact, the magnitude of the poverty elasticity (–0.020) is even smaller.

When poverty is defined more broadly – those with incomes falling below 125 per cent of the poverty line – estimates remain statistically insignificant and small across all individuals (column 3) and workers (column 4). Finally, when we estimate poverty as those with family incomes below 150 per cent of the poverty line (columns 5–6), the estimate of β_1 actually becomes positive, though still statistically indistinguishable from zero.

3 Our results do not substantially change when we use the household unit to calculate poverty.

4 During this period, the 28 states that raised their minimum wages were: AZ, AR, CA, CO, CT, DE, DC, FL, HI, IL, ME, MD, MA, MI, MN, MO, NV, NH, NJ, NY, NC, OH, OR, PA, RI, VT, WA, and WI. The Federal minimum wage rose from $5.15 to $5.85 per hour on July 24, 2007.

Table 1. Estimates of relationship between the minimum wage and log of state poverty rates, 2003–2007

	Poverty rate (INR< 1.0)		Poverty rate (INR< 1.25)		Poverty rate (INR<1.5)	
	Overall	Workers	Overall	Workers	Overall	Workers
	(1)	(2)	(3)	(4)	(5)	(6)
Log (minimum wage)	–0.052 (0.146)	–0.020 (0.203)	–0.016 (0.104)	–0.013 (0.186)	0.004 (0.132)	0.045 (0.196)
Prime-age male unemployment rate	1.71** (0.754)	1.52* (0.901)	1.52** (0.025)	1.59** (0.779)	0.748 (0.599)	0.560 (0.658)
Log (average adult wage rate)	–0.103 (0.121)	–0.025 (0.155)	–0.072 (0.101)	–0.010 (0.136)	–0.21 (0.090)	0.013 (0.107)
Percentage of individuals aged 54–64	0.558 (1.00)	0.059 (1.11)	0.013 (0.780)	–0.933 (1.06)	0.447 (0.645)	–0.487 (0.836)
Percentage of individuals aged 16–24	2.18*** (0.681)	3.49*** (1.26)	1.23* (0.672)	2.20** (1.03)	0.529 (0.540)	0.989 (0.695)
State effects?	Y	Y	Y	Y	Y	Y
Year effects?	Y	Y	Y	Y	Y	Y
Mean of dependent variable	0.108	0.059	0.144	0.067	0.183	0.093
N	225	255	255	255	255	255

***Indicates significance at the 1 per cent level **Indicates significance at the 5 per cent level *Indicates significance at the 10 per cent level
Notes: The poverty rate is calculated using family income and the family size-adjusted poverty line. Adult wage measures and unemployment rates are calculated for those aged 25–54. All regressions are weighted by the relevant population of workers and standard errors are corrected for clustering on the state.
Source: Sabia and Burkhauser (2008b, Table 1)

Taken together, the estimates in Table 1 suggest that minimum wage increases enacted between 2003 and 2007 had no effect on state poverty rates, much like past minimum wage increases (Card and Krueger, 1995; Burkhauser and Sabia, 2007). One reason for this finding may be adverse labour demand effects found in the general minimum wage literature and more specifically estimated by Neumark and Wascher (2002) and Neumark *et al*. (2004, 2005) but another may be their poor target efficiency. We now turn to Sabia and Burkhauser's (2008b) discussion of who would gain from the newly proposed federal minimum wage increase to $9.50 per hour.

5. Who benefits from minimum wage increases?

Table 2 from Sabia and Burkhauser (2008b) shows cross-tabulations of the wage distribution of non-self-employed 16–64 year olds by the income-to-needs ratio of their households (the ratio of their household's pre-tax post-transfer income to the poverty line for a household of that size) using the March 2008 CPS.

Table 2. Wage distribution of all workers in 2008 by income-to-needs ratio of their household

	Hourly wage categories[a]								
	$0.01 to $5.69	$5.70 to $7.24	$7.25 to $9.49	$9.50 to $11.99	$12.00 to $15.99	$16.00 and over	Total	Percent of all workers	Per cent of workers earning more than $5.70 and less than $9.49
Income-to-needs ratio									
Less than 1.00	5.7	12.7	32.7	19.5	15.5	13.9	100.0	4.4	11.0
1.00 to 1.24	2.3	10.1	32.1	22.1	19.7	13.8	100.0	2.6	6.1
1.25 to 1.49	6.1	10.4	30.7	22.5	19.2	11.2	100.0	2.5	5.9
1.50 to 1.99	3.6	6.7	30.0	20.2	21.7	17.8	100.0	6.4	13.3
2.00 to 2.99	2.8	5.4	17.2	19.6	28.2	26.7	100.0	16.3	21.2
3.00 or above	1.4	2.8	8.2	8.9	17.6	61.1	100.0	67.8	42.5
Whole category share[b]	2.1	4.3	13.3	12.5	19.6	48.2	100.0	100.0	100.0

[a]Hourly wage rates are based on a direct question concerning earnings per hour on their current primary job. All household income data used to calculate income-to-needs ratios come from retrospective information from the previous year because that is the period for which it is reported. Wages are in 2008 dollars.
[b]Share of all workers with wage earnings in each category
Source: Sabia and Burkhauser (2008b, Table 2).

Each column shows a different wage category and each row shows the income-to-needs ratio of workers' households. Workers who are expected to be directly affected by the proposed increase are those who earn between $7.25 and $9.49 per hour. However, in March 2008, when wage rates of workers are measured, the federal minimum wage was $5.85 per hour. The federal minimum wage was increased to $6.55 on July 24, 2008 and will increase again to $7.25 on July 24, 2009. We take a conservative approach and assume that workers earning between $5.70 and $9.49 in March 2008 will be affected by the newly proposed federal minimum wage increase.[5] Those who earned less than $5.70 per hour are assumed to be in the sector uncovered by the Federal minimum wage, such as tipped employees and restaurant workers.

Only a small minority of workers will be affected by the newly proposed federal minimum wage increase. Only 17.7 per cent of all workers in the US earned hourly wages between $5.70 and $9.49 per hour and stand to be directly affected by the increase, while 80.3 per cent of all workers earn hourly wages of $9.50 per hour or more.

To assess how well the proposed federal minimum wage hike will target the working poor, we first examine the share of workers living in poor households who will be affected by the new federal minimum wage increase. Just 4.4 per cent of all workers live in poor households. But not all of them will be affected by this minimum wage increase since 48.9 per cent already earn wages greater than $9.50 per hour.

The final column of Table 2 shows the distribution of workers who earn between $5.70 per hour and $9.50 per hour by the income-to-needs ratios of their households. Only 11.0 per cent of these minimum wage workers live in poor households. When workers living in near poor households are also included (households with income-to-needs ratios between 1.0 and 1.5), this number rises to 23.0 per cent. However, 63.7 per cent of minimum wage workers live in households with incomes over twice the poverty line, and 42.5 per cent live in households with incomes over three times the poverty line ($61,950 for a four-person household), which is over twice the US household median income in 2007 (DeNavas-Walt e*t al.*, 2008).

5 Following Burkhauser and Finegan (1989), Burkhauser, Couch, and Glenn (1996), and Burkhauser and Sabia (2007), we assume that workers earning $0.15 below the Federal minimum wage – in this case, those earning hourly wages between $5.70 and $5.84 per hour in March 2008 – are working in jobs covered by the Federal minimum wage and their wages simply reflect reporting error.

In summary, the descriptive evidence in Table 2 suggests that raising the federal minimum wage to $9.50 per hour will not be a target efficient anti-poverty tool because (i) many poor and near-poor workers already earn hourly wages greater than $9.50 per hour, and (ii) most workers who will benefit are not poor.

5.1 Simulations with behavioural effects

Poor target efficiency is one important reason why minimum wage increases are ineffective at reducing poverty; adverse labour demand effects are another. In Table 3, taken from Sabia and Burkhauser (2008b), we simulate expected job losses from the proposed federal minimum wage increase. To simulate the employment and distributional consequences of a newly proposed federal minimum wage increase from $7.25 to $9.50 per hour, in Sabia and Burkhauser (2008b), we follow Baicker and Levy (2008), Burkhauser and Simon (2008) and Yelowitz (2008) who use estimates of employment elasticities from the minimum wage literature to simulate the effect of pay-or-play health insurance reforms. We use a range of elasticities for minimum wage workers that range from zero (Card and Krueger, 1995; Addison e*t al.*, 2008; Dube e*t al.*, 2008), to 'consensus' elasticities of –0.1 to –0.3 (Neumark and Washer, 2007), to upper-bound estimates of –0.6 to –0.77 (Burkhauser, Couch and Wittenburg, 2000b; Sabia, 2008a; Sabia and Burkhauser, 2008a). Thus, the distribution of job loss by income-to-needs ratio of households will depend on (i) the share of minimum wage workers in each income-to-needs category, (ii) the magnitude of the gap between the worker's current wage and the new federal minimum wage, and (iii) the elasticity that should be applied to each worker. Total job loss is calculated by summing the product of the individual probabilities of job loss and the population weights attached to each worker.

Table 3. Simulated employment losses of proposed Federal minimum wage increase to $9.50 per hour, by household income-to-needs ratio[a,b]

	Per cent of workers earning more than $5.70 and less than $9.49[a,b]	Number of workers in thousands	Employment losses in thousands (e = –0.1)[c]	Employment losses in thousands (e = –0.3)[c]	Employment losses in thousands (e = –0.6)[d]	Employment losses in thousands (e = –0.77)[d]	Per cent of total job loss
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Income-to-needs ratio							
Less than 1.00	11.0	2,451	59.3	177.9	355.8	455.4	12.1
1.00 to 1.24	6.1	1,355	29.4	88.2	176.4	226.1	6.0
1.25 to 1.49	5.9	1,304	28.7	86.1	172.2	220.8	5.9
1.50 to 1.99	13.3	2,960	60.8	182.4	364.8	467.5	12.4
2.00 to 2.99	21.2	4,731	103.2	309.6	619.2	793.2	21.0
3.00 or above	42.5	9,462	208.0	624	1,248	1,598	42.5
Total	100.0	22,263	489.5	1,469	2,937	3,761	100.0

[a]Hourly wage rates are based on a direct question concerning earnings per hour on their current primary job. All household income data used to calculate income-to-needs ratios come from retrospective information from the previous year because that is the period for which it is reported. Wages are in nominal dollars. Sample restricted to 16–64 year-olds who report positive weeks and weekly hours worked in previous year.
[b]This wage category corresponds to March 2008.
[c]Consensus estimates in minimum wage literature (see Neumark and Wascher, 2007).
[d]Upper-bound estimates found in new minimum wage literature (see Burkhauser, Couch, and Wittenberg, 2000b, Sabia, 2008a, Sabia and Burkhauser, 2008a).
Source: Sabia and Burkhauser (2008b, Table 6).

We estimate that the proposed hike to $9.50 per hour will affect over 22 million workers (final row, column 2), including 2.45 million workers living in poor households and 2.66 million living in near poor households. To estimate job losses, we calculate individual probabilities of job loss using the above-mentioned range of employment elasticities.

Columns (3) and (4) present estimates of job losses by income-to-needs ratios of households using 'consensus' estimates in the literature (Neumark and Wascher, 2007), while columns (5) and (6) present simulations using upper-bound estimates of –0.6 and –0.77 (Burkhauser, Couch and Wittenberg, 2000b; Sabia, 2008a; Sabia and Burkhauser, 2008a). Lower-bound elasticity estimates imply job losses of 489,000 to 1.47 million, while upper-bound estimates imply job losses of approximately 3 to 4 million.

Importantly, the share of job losses experienced by workers in poor households (12.1 per cent; column 7, row 1) is larger than the share of minimum wage workers who are poor (11.0 per cent). This is because their hourly wage rates were on average lower than those of affected workers living in non-poor households, thus leading to a higher probability of job loss. But this is likely to understate the actual difference between workers living in poor and non-poor households, since the demand for these workers may be more elastic than that of non-poor workers as a group (see, for example, Sabia, 2008a).

While job losses are certainly likely given the consensus of existing empirical evidence (Neumark and Wascher, 2007, 2008), net income gains are still possible if adverse employment effects are sufficiently small. But are the gains from minimum wage increases received, in the main, by the working poor as proponents expect? In Table 4 from Sabia and Burkhauser (2008b), we simulate the expected monthly benefits from the proposed Federal minimum wage hike to $9.50 per hour. Column (1) shows the distribution of monthly benefits assuming no behavioural effects of the minimum wage. If no minimum wage workers are laid off and none have their hours reduced, the minimum wage increase is simulated to yield $4.2 billion in monthly benefits. This estimate can be considered an upper-bound estimate of benefits, given our optimistic behavioural assumptions. However, even under these assumptions, just $445 million of these benefits (10.6 per cent) will be received by the working poor (column 2) and 23.9 per cent of the benefits will be received by workers living in poor or near poor households. Nearly 62 per cent of the benefits will be received by workers in households with incomes over twice the poverty line, and 40.9 per cent will be received by workers in households with incomes over three times the poverty line. Thus, even under optimistic assumptions of zero employment, only a small share of the benefits will be received by the working poor.

Table 4. Simulated monthly net benefits from proposed federal minimum wage increase to $9.50, by household income-to-needs ratio[a,b]

	Net benefits in billions $ (e = 0)	% Net benefits (e = 0)	Net benefits in billions $ (e = –0.1)	Net benefits in billions $ (e = –0.3)	% Net benefits (e = –0.3)	Net benefits in billions $ (e = –0.6)	Net benefits in billions $ (e = –0.77[c])
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Income-to-needs ratio							
Less than 1.00	0.445	10.6	0.386	0.269	10.5	0.0932	–0.005
1.00 to 1.24	0.288	6.8	0.251	0.177	6.9	0.0648	0.002
1.25 to 1.49	0.273	6.5	0.238	0.168	6.5	0.0632	0.004
1.50 to 1.99	0.596	14.2	0.520	0.368	14.1	0.140	0.012
2.00 to 2.99	0.885	21.0	0.769	0.536	21.0	0.186	–0.010
3.00 or above	1.72	40.9	1.50	1.05	41.0	0.374	–0.004
Total	4.21	100.0	3.66	2.56	100.0	0.921	0.000

[a]Expected benefits are calculated as the weighted sum of (1-p)($9.50-w)H – pwH for each minimum wage worker, where p is the probability of job loss from the minimum wage hike, [($9.50-w)/w]e, w is the worker's hourly wage rate, H is monthly hours worked, and e is the employment elasticity.
[b]The analysis uses data from the outgoing rotation groups of the March 2008 CPS. A minimum wage worker is defined as earning between $5.70 and $9.49 per hour in March 2008. Sample restricted to 16–64 year-olds who report positive weeks and weekly hours worked in previous year.
[c]The break-even elasticity is –0.7683.
Source: Sabia and Burkhauser (2008b, Table 8).

In columns (3)–(8), we allow for behavioural effects of the federal minimum wage increase. At a conservative employment elasticity of –0.1, the total net benefits from the minimum wage fall by 13.1 per cent to $3.66 billion, but the distribution of benefits remains similar to that when no employment effects were assumed: approximately 10.5 per cent of benefits are received by workers living in poor households.

At higher employment elasticities, net benefits fall substantially. An employment elasticity of –0.3 reduces net benefits by 39.2 per cent to $2.56 billion (column 4), and an elasticity of –0.6 reduces net benefits by 78.1 per cent to $0.921 billion (column 5). We estimate the 'break-even' employment elasticity where net benefits are zero to be –0.77 (column 7). While an employment elasticity of –0.77 is large relative to the consensus estimates in the literature, a few studies have found estimates as large for less-educated single mothers (Sabia, 2008c) and young dropouts (Burkhauser, Couch, and Wittenberg, 2000b; Sabia and Burkhauser, 2008a). Each of these low-skilled groups is more likely to be poor than other minimum wage workers (i.e. teenagers); thus, it is not implausible to imagine that the benefits of a minimum wage increase to $9.50 to the working poor workers would be quite small, or even negative.

6. What does the American experience mean for Australia?

Our reading of the 70 years of American experience since the passage of the FLSA1938 (and the creation of the first federal minimum wage in the US) is that the answers to the important questions posed by Stigler — (1) Does such legislation diminish poverty?, and (2) Are there efficient alternatives? — are indeed no and yes. We have reviewed the evidence on the effectiveness of increases in the minimum wage as a mechanism for reducing poverty including the most recent ones. As with previous minimum wage increases, the minimum wage increases between 2003 and 2007 had no effect on state poverty rates. Moreover, the proposal to raise the federal minimum wage to $9.50 per hour is unlikely to be any better at reducing poverty for the reasons that Stigler foretold, (i) many poor workers (48.9 per cent in our simulations) already earn hourly wages greater than $9.50 per hour, (ii) most workers (89.0 per cent in our simulations) who are affected are not poor, and (iii) the minimum wage increase is likely to cause adverse employment effects for the working poor. Worse still, the target efficiency of federal minimum wage increases is not improving, and may actually be worsening. When compared to the last federal increase, the current proposal appears even less target efficient than previous increases with only 10.5 per cent going to the working poor. At an employment elasticity of –0.3 for minimum wage workers, we forecast that nearly 1.5 million low-skilled workers will lose their jobs if the federal minimum wage is raised to $9.50 per hour, including 178,000 jobs held by the working poor. And at employment elasticities greater than –0.77, we estimate that net monthly benefits from the minimum wage increase will actually become negative.

As raising the federal minimum wage has become an increasingly ineffective anti-poverty strategy, expansions in the EITC program provide an increasingly better alternative. Because EITC eligibility is based on family income rather than a wage rate, its benefits are more likely to go to workers living in poor families (Neumark and Wascher, 2001; Burkhauser, Couch and Glenn, 1996; Burkhauser and Sabia, 2007 and Congressional Budget Office, 2007). Thus, most of the 48.9 per cent of poor workers who earned hourly wages greater than $9.50 per hour in March 2008 and would not gain from the proposed increase in the federal minimum wage, could gain from expansions in the EITC. Because the costs of the EITC are not directly borne by employers, expansions in this wage subsidy do not cause adverse labour demand effects. In fact, a large body of empirical literature finds that an expansion in the EITC increases employment among low-skilled single mothers

(Eissa and Liebman, 1996; Ellwood, 2000; Meyer and Rosenbaum, 2000, 2001; Hotz e*t al.*, 2002; Grogger, 2003; Hotz and Scholz, 2003; and Eissa and Hoynes, 2005). Given that employment is an important anti-poverty mechanism and wage subsidies can increase income to the working poor, expansions in the EITC will be a more effective means of aiding the working poor than increasing the federal minimum wage.

What does the American experience suggest for Australia? The laws of physics and economics are the same in both the US and Australia. The scarcity of evidence on positive or negative employment effects of Australia's minimum wage laws is due to the lack of appropriate data. In the US, the spurt in state minimum wage laws above the Federal minimum over the past decade has provided researchers with a rich set of natural experiments to test the consequences of such increases on employment and poverty rates. Unlike the US, it is far more difficult to measure its effects in Australia, where there is very little variation across states.

However, circumstantial evidence suggests that Australia's labour markets have not escaped the laws of supply and demand. In their 2008 report, the Australian Fair Pay Commission (2008, Table D.1, p. 107) found that Australia's gross minimum wage adjusted by purchasing power parity exchange rates was among the four highest of the 14 OECD countries with statutory minimum wages at $13.74 (Australian dollars) in May 2008, less than one dollar below second and third ranked France and the Netherlands, more than one dollar above fifth ranked Belgium and far above the 10th ranked US at $8.36. The relatively high minimum wage in Australia relative not only to the US but also to other OECD countries makes it unlikely that these mandates have not had some negative effect on the employment of low-skilled labor.

Another piece of evidence may be the dog that didn't bark. Low-skilled, never-married single mothers in Australia are far less likely to be working than in the US both because it is difficult for them to find work at your relatively high minimum wage and because Australia offers much higher and more permanent benefits to single mothers who do not work and penalises those who do. Reforms in the US dramatically reduced the number of single mothers on the welfare rolls after 1996 and even more dramatically increased their employment so that on average their income rose and their poverty rates fell (Meyer and Rosenbaum, 2000, 2001; Blank, 2002; Burkhauser, Daly, Larrimore and Kwok, 2008).

The principal positive incentive offered to single mothers who worked was a substantial increase in the wage subsidies paid to them via the EITC. The EITC is now the primary federal cash transfer paid to the vast majority of never married single mothers who now work. The EITC effectively raises the minimum wage for single mothers and has played a large role in their movement into the labour force since 1996. The dramatic improvement in the employment and income of never married single mothers in the US since 1996 was the result of a policy change that raised the effective wage of low-skilled workers. (Ellwood, 2000; Meyer and Rosenbaum, 2000, 2001; Grogger, 2003) But unlike a minimum wage increase, the EITC did not do so by mandating that employers raise the wages they pay to poor and non-poor workers alike. Increases in the Australian minimum wage since 1996 have resulted in no such dramatic improvement in the employment and economic well being of never married single Australian mothers – why didn't that dog bark? One reason may be that Australia did not take the advice in the *Five Economists* letter (Dawkins, 1999, 2002) and substitute an Australian version of the EITC for further increases in the Australian minimum wage.

Researchers do have sufficient data to consider the target efficiency of Australian minimum wage increases. Most recently, Wooden, Wilkins and McGuinness (2007) use HILDA data to produce tables very similar to those reported here in Table 2 that show that the vast

majority of low-wage Australian workers do not live in poor households where they define poor as among either the lowest 10 or 20 per cent of persons based on their household's size-adjusted after tax income. Based on their analysis, these authors argue that further increases in the minimum wage will do little to help the working poor. Leigh (2007) uses data from various waves of the Survey of Income and Housing, but presents results that are less directly comparable to those reported here in Table 2 or to the findings of Wooden, Wilkins, and McGuinness (2007). This is because even in the broadest population he examined, Leigh (2007) excluded children under the age of 15 and hence did not report the distribution of minimum wage job holders across the household size-adjusted income of all persons living Australia. Nonetheless, he also found that the vast majority of low-wage earners do not live in low-income households.

Using the same methods described in this paper, it is likely that simulations of further increases in the Australian minimum wage system, assuming no negative behavioural effects, would produce the same results as discussed here for the US. The vast majority of those who gain from any minimum wage increase will not live in poor households and a considerable share of the working poor will not gain since they already earn wages above the minimum. When modest assumptions are made with respect to the negative impact of the minimum wage on employment as we report in Table 3, the benefits of any minimum wage increase will be even lower. Given this reality, isn't it time for the Australian Fair Pay Commission to take the Stigler challenge? (1) Do its mandated minimum wage polices diminish poverty?, and (2) Are there efficient alternatives? We suspect the answers are, respectively, no and yes. Shouldn't the Australian Fair Pay Commission know the answers to these questions before recommending a new round of minimum wage increases?

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Forum discussion

General discussion following the presentation focussed primarily on differences between the United Kingdom (UK) and the United States (US) on the following issues:

- the effectiveness of minimum wages in alleviating poverty; and
- the size and direction of employment effects of increases in minimum wages.

The effectiveness of minimum wages in alleviating poverty is a contentious issue. Some participants pointed to US and Australian evidence that most minimum wage workers live in middle-income households, though it was claimed that this is not the case in the UK. The minimum wage was also felt to be of limited use as an anti-poverty tool because it cannot assist those who are not employed. Others, however, contended that OECD countries with high minimum wages often have more compressed wage distributions, inferring that minimum wages may lead to lower poverty rates through this mechanism. It was also proposed that higher minimum wages lead to higher-quality jobs, and more investment in training.

Some concern was expressed about the appropriateness of using poverty benchmarks that are implicitly designed for people who are not employed. This raises the issue of whether employed people should have the same minimum standard of living as people outside the labour force.

There was also a range of opinions on whether or not a key purpose of mandated minimum wages is to protect workers from exploitation. Some participants argued strongly that intervention between employers and employees is warranted to redress power imbalances. The opposing view was that the employees being 'exploited' are often teenagers in middle or upper income families who are unlikely to remain on minimum wages, but rather receive higher wages as their work experience grows. Hence there is little rationale for protecting these employees rather than focussing on lower income employees who support a family. This led to discussion on the relative importance of analysing the wage distribution (individual outcomes) versus looking more closely at the households in which these individuals live and focussing on how minimum wage increases affect income distribution (household outcomes).

There was spirited discussion about the size and direction of the employment effects of minimum wages. There is no UK evidence of negative employment effects, whereas the opposite is more commonly found in the US. It was argued that adverse effects would be found in the UK and Australia if there was similar regional variation in their minimum wages. However, it was also suggested that the US evidence based on this regional variation exaggerated these employment effects.

It was noted that, while there is substantial US evidence on minimum wage effects, institutional and cultural differences require each country to do its own research for evidence-based policy-making. This was countered by the claim that, like the laws of physics, economic laws hold in all countries. Finally, it was suggested that countries with high poverty rates could learn from the experience of countries with more regulated and centralised systems that tend also to have lower poverty rates.

Forum discussion summary prepared by the Australian Fair Pay Commission Secretariat.