Tax Incentives for Business in Response to a Minimum Wage Increase
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Nobel laureate Milton Friedman once said:

> "One of the great mistakes is to judge policies and programs by their intentions rather than their results...[P]rograms that are labeled as being for the poor, for the needy, almost always have effects exactly the opposite of those which their well-intentioned sponsors intend them to have."[1]

The minimum wage is an example of this type of ill-conceived policy.

Minimum wage advocates argue passionately that no one who works hard and plays by the rules should be poor. I agree, as do most Americans. But, I also agree with Milton Friedman that good intentions are not enough to make good policy. The real test of this legislation is how its passage will impact the working poor. Here the evidence is clear – past minimum wage increases have not alleviated poverty and this legislation will not do so either.

A forthcoming peer-reviewed publication coauthored with my colleague, Richard Burkhauser, examines Census data from 1989 to 2004 and finds that minimum wage increases had no effect on overall poverty rates, on poverty rates among workers, or on poverty rates of working single mothers.[2] These findings, consistent with several previous studies[3,4,5], provide compelling evidence that minimum wage hikes are a poor antipoverty tool.

There are two reasons for this surprising result. First, individuals cannot be lifted out of poverty by a minimum wage increase if such a hike causes them to lose their jobs or have their hours significantly reduced. While some low-skilled workers who remain employed after a minimum wage hike are moved out of poverty, other low-skilled workers are moved into poverty as a result of adverse employment effects. Research by David Neumark shows that the net effect simply redistributes income among low-income families.[3] The net effect of past minimum wage hikes generally leaves low-skilled workers worse off.[3,5]

Recently, economists David Neumark and William Wascher published a paper for the National Bureau of Economic Research in which they critically review nearly 90 empirical articles that have been published since the early 1990s on the effects of the minimum wage.[6] They conclude that the evidence is "overwhelming" that the least-skilled workers experience the strongest disemployment effects from minimum wage increases.[7] Those workers most harmed are disproportionately workers without a high school diploma[7], young African-Americans[8], and single mothers.[9]

The estimated adverse employment effects are not trivial in magnitude. Burkhauser et al.[7] find that a 10 percent increase in the minimum wage results in an 8.5 percent decline in employment of African-Americans aged 16-24, a 5.7 percent reduction in teenage employment, and an 8.5 percent decline in non-high school graduate employment among those aged 20-24. Sabia[8] finds that a 10 percent hike in the minimum wage results in a 2.4 to 3.8 percent reduction in single mothers' employment, and even larger disemployment effects for single mothers without a high school diploma, with elasticities ranging from -0.68 to -1.4.

Among single mothers, there is growing evidence that minimum wage increases have the unintended consequence of increasing welfare use.[8,10] A study published last year in a peer-reviewed public policy journal found that a 10 percent increase in the minimum wage is associated with a 1 to 2 percent increase in welfare caseloads.[9] Sabia[8] finds that these welfare effects are even larger for less educated single mothers. Taken together, this body of literature suggests that while a growing economy, pro-work welfare reforms, and expansions in the Earned Income Tax Credit increased labor force participation and decreased poverty of single mothers during the 1990s and early 2000s, minimum wage increases actually undermined these gains.

Moreover, it is primarily sectors of the economy that employ low-skilled laborers—particularly retail and small businesses—that experience adverse employment effects. Sabia[11] finds that a 10 percent increase in the minimum wage is associated with a 1 percent reduction in retail and small business employment.

Reducing employment is not the only means by which employers respond to minimum wage increases. In fact, focusing one's attention only on employment effects will actually understate the total adverse effects of a minimum wage increase. Employers can also respond to a minimum wage increase by reducing employees' work hours. Couch and Wittenberg[12] find that a 10 percent increase in the minimum wage reduces average hours worked by teenagers by 5 to 6 percent. Sabia[16] finds that a 10 percent increase in the minimum wage results in a 6 to 8 percent reduction in hours worked by single mothers without a high school diploma.

However, adverse employment effects are not the only reason—or even the central reason— why minimum wage increases fail to reduce poverty. A second reason is that in contrast to 1938 when the minimum wage was first mandated, today, the vast majority of workers who benefit from a minimum wage increase do not live in poor or even near poor households. In 1938, many low-wage employees headed poor households. So, it was much more likely that a raise in the minimum wage would transfer dollars to poor families. But since then, the relationship between earning a low wage and living in poverty has become weaker and weaker. By 2003, only 9 percent of low-wage workers were heads of poor households. The vast majority are second or even third earners in households with incomes that are more than two or even three times greater than the poverty line. Less than 5 percent are poor single mothers.[13]

Only 13 percent of workers who earn between $5.00 per hour and $7.25 per hour live in poor families, while 64 percent live in families with earnings more than twice the poverty line. Moreover, almost two-thirds of workers who live in poor families already earn wage rates greater than $7.25 per hour and will not be directly helped by a federal minimum wage increase.

In our new paper, Burkhauser and I simulate the effects of a federal minimum wage hike from $5.15 per hour to $7.25 per hour to see who would benefit.[14] To give the minimum wage its best chance to reduce poverty, we put on rose-colored glasses and assumed that there would be no adverse employment effects associated with the minimum wage increase. Even in this best case scenario, we found that just 13 percent of the benefits would go to workers in poor households; two-thirds of the benefits would go to those living in households with incomes at least two times the poverty line, and over 40 percent of the benefits would go to workers in households with incomes over three times the poverty line. For a household of four in 2006, that corresponds to household income greater than $60,000. Poor African-Americans would receive only 3.7 percent of the benefits and poor single mothers only 3.8 percent. And again, these are the best case estimates, assuming that no one loses her job or has her hours reduced as a result of a minimum wage increase. Hence, the paltry benefits we report accruing to the working poor may, in fact, be overstated.

In summary, raising the minimum wage is an ineffective antipoverty tool because it does not target the population of poor workers we would most like to help, and because it diminishes work opportunities for many low-skilled workers.

Excluding the costs of any adverse employment effects, we estimate that the cost of this minimum wage hike will be over $18 billion dollars, which will, in part, be passed on to consumers in the form of higher prices for products.[15] Given the high costs of this minimum wage increase, and the small share of the benefits that will actually accrue to poor families, it is difficult to justify a minimum wage hike on antipoverty grounds.

The evidence clearly shows that minimum wage increases are a poor way to help the working poor. A far more effective antipoverty tool is the Earned Income Tax Credit (EITC). The federal EITC program provides tax credits to poor working families. A minimum wage worker from a low-income family with two or more children stands to gain a credit of 40 cents for every dollar in wages earned. Such employees have an effective wage of $7.21 per hour. In states that provide EITC supplements, they can earn even more.

Importantly, in contrast to the minimum wage, the EITC is based on family income, not on a wage rate. Hence, a worker earning more than $7.25 per hour but who lived in a low-income family is eligible for the credit. Such a worker would gain nothing from a minimum wage increase to $7.25 per hour. Furthermore, the vast majority of minimum wage workers who do not live in low income families do not received EITC benefits. Thus the EITC is much more target efficient than the minimum wage.[16]

Most poor households—especially single mothers and African-Americans—would benefit from the EITC, while only a minority would gain from a minimum wage hike. And because EITC costs are not borne by employers, there will be no reduction in demand for low-skilled workers, as is the case with a minimum wage increase. My research shows that a 10 percent increase in the maximum EITC refundable credit reduces poverty rates by 7 percent among full-time employed single moms.[17]

Let us all agree that no American who works hard and plays by the rules should be poor. But good intentions cannot justify bad policy. Minimum wage increases are useless at best and downright harmful at worst. They should be abandoned and placed in the museum of antiquated antipoverty policies.

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