

A higher minimum wage is unlikely to accomplish the stated goal of raising the living standards of the working poor. And given Hawaii's highly service oriented economy, the negative impact of an increased minimum wage may have a larger impact than in other states.

Raising the minimum wage may be one of the hottest issues of this year's legislative session. Two bills have been introduced to increase the minimum wage. One bill would raise the minimum wage from \$7.25 to \$8.75 by July 2014. The second proposal would raise the minimum wage to \$7.75 in six months. It is reported that Governor Neil Abercrombie supports the first bill, increasing the minimum wage by \$1.50 by next year. Both bills also propose indexing the minimum wage so that it is adjusted for future inflation. President Obama made a similar proposal, to increase the federal minimum wage from \$7.25 to \$9 and index it for inflation, in his [2013 State of the Union speech](#) earlier this month.

According to proponents, raising Hawaii's minimum wage is necessary to help the working poor, since wages have not kept up with the high cost of living in Hawaii, and to stimulate retail activities as it pumps dollars into the economy. According to opponents, an increase will raise business costs especially for small businesses, resulting in the elimination of unskilled jobs and higher prices for consumers.

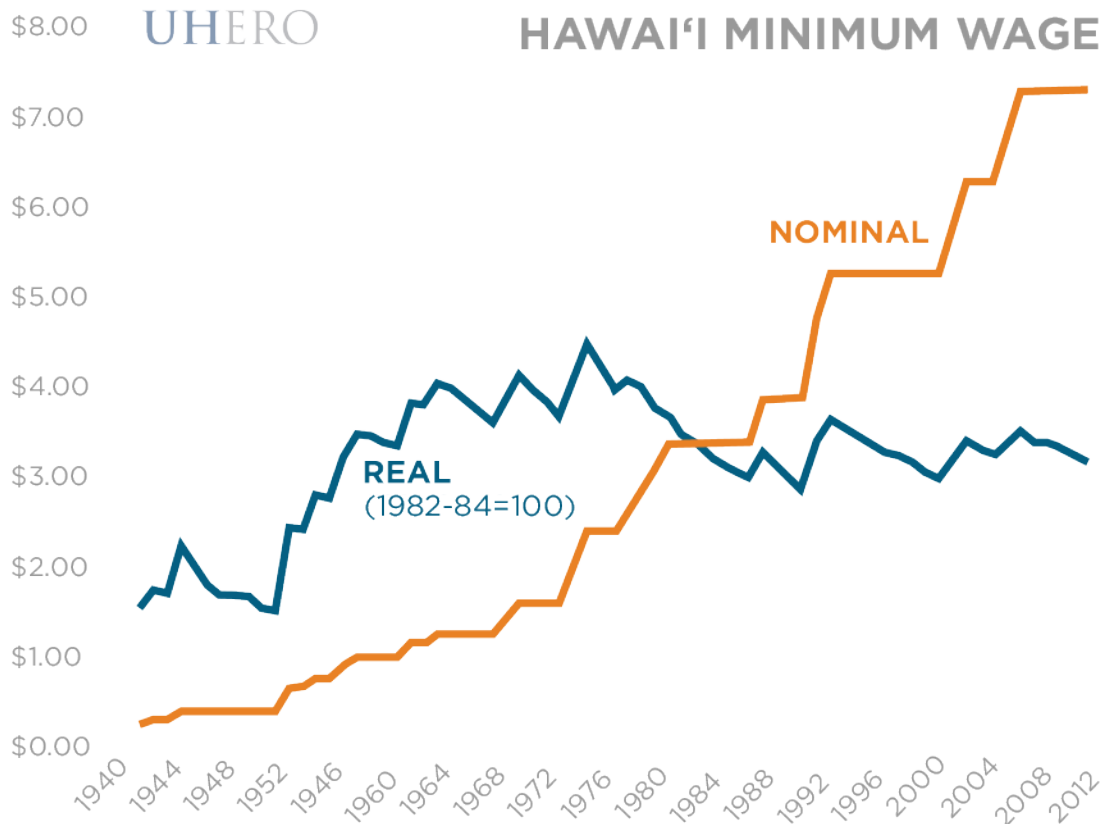
This UHERO Brief addresses both sides of the minimum wage debate by drawing on a vast economic literature on the subject. That literature suggests that a small increase in Hawaii's minimum wage is unlikely to significantly reduce the number of jobs available to unskilled workers.

At the same time, a higher minimum wage is unlikely to accomplish the goal of its proponents—raising the living standards of the working poor. Nevertheless, politicians may choose to raise the minimum wage since it is both symbolic and does not require any reduction in tax revenues or increase in expenditures for income subsidies.

In 1938 President Roosevelt signed the Fair Labor Standards Act (FLSA), establishing a national minimum wage. Since then the federal minimum wage has been increased 21 times, from \$0.25 per hour in 1938 to \$7.25 per hour in 2009. Forty-five states have applicable minimum wage laws, with the highest state minimum wage currently \$9.19 per hour in Washington State.

Where a state requires a different minimum wage, the higher standard applies. Hawaii's minimum wage has been \$7.25 per hour since 2007, which is same as the current federal minimum wage. Even though Hawaii's minimum wage was raised in 2007, in real terms (adjusting for inflation) it has declined since the mid 1970s.

There is little doubt that the minimum wage helps to prevent the exploitation of workers and establishes a wage floor for unskilled and part-time workers. However, there are two important questions that should be addressed in any minimum wage debate. First, does raising the minimum wage produce adverse effects on some workers? Second, is the minimum wage an effective policy



tool for helping the working poor?

Economic theory predicts that a binding minimum wage will reduce employment of unskilled and part-time workers, since businesses will find it unprofitable to hire such workers. The excess supply of labor is dispersed in several ways. Some workers will wait in a queue of unemployed workers seeking the minimum wage jobs. Others may find it optimal to accept employment in a sector that is not subject to the minimum wage. Thus, theory predicts that some workers will benefit from an increase in the minimum wage, while others will be unable to find jobs because businesses will reduce the number of unskilled workers they hire.

What does the empirical evidence tell us? Most research into the effects of the minimum wage on employment has focused on the demand

for teenage workers, since they are primarily inexperienced and low skilled workers. As is often the case in the social sciences, the empirical evidence is mixed. One set of studies, led by David Card and Alan Krueger (who is also head of the White House Council of Economic Advisers) finds that increasing the minimum wage does not have significant adverse effects on employment. Other studies reach the opposite conclusion, notably the work of David Neumark and William Wascher (2007).

Many studies find that the minimum wage has reduced employment among young people. The estimates vary, but they cluster around a reduction in teen employment of between 1 and 3 percent for each 10 percent increase in the minimum wage. In contrast, David Card and Alan Krueger (1997) find evidence that a higher minimum wage

actually increases employment among teenagers. The results from their study remain controversial, and after hundreds of studies there is no consensus about the effects of minimum wage laws on employment. The most serious criticism of the Card and Krueger research comes from a series of studies by Neumark and Wascher. For example, Neumark and Wascher (2007) review more than 90 studies published since the mid-1990s and conclude that there is very little convincing evidence of positive employment effects of minimum wages. According to Neumark and Wascher, studies that have focused on the least-skilled workers provide overwhelming evidence of dis-employment effects for those workers. Median employment elasticities (sensitivities to minimum wage changes) from the literature range from -0.1 to -0.3 (Sabia and Burkhauser, 2010); however, several studies have found larger elasticities for less educated single mothers (Sabia, 2008) and younger high school dropouts (Burkhauser et al., 2000).

Firms may also respond to minimum wage hikes by reducing both employment and average hours worked by employed workers, or by increasing hours of retained workers to compensate for reduced employment. The empirical results on the effect on hours worked are also mixed in the existing literature. Couch and Wittenburg (2001) find some evidence that hours worked change under minimum wage laws, but Zavodny (2000), Sabia (2008), and Sabia and Burkhauser (2008) find little evidence of such effects.

The net effect of the minimum wage increase in practice will depend on how many workers have their wages raised, and how many workers fail to find employment or lose their job because of the higher wage. If the number of workers

who are affected by the higher minimum wage is very small, then it is unlikely that a small change in minimum wage will have substantial effect on employment opportunities. This kind of estimation requires complex research that is beyond the scope of this brief. However, a very rough estimate of the wage distribution in the United States can give a hint at how many workers might be affected by an increase in the minimum wage. In 2009, about 5 percent of hourly paid workers received wages at or below \$7.25 (<http://www.bls.gov/cps/minwage2009.htm>). The bottom 10 percentile earnings of all workers was \$8.90 for men \$8.00 for women in 2009. The 50th percentile for women was only \$15.10 (<http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/120xx/doc12051/02-16-wagedispersion.pdf>). Considering that about 60 percent of workers are hourly paid workers, at least 10-12 percent of hourly paid workers received a wage below \$8.90 in 2009 in the United States.

Is Hawai'i different? The most underpaid jobs nationally are waiters and waitresses, food preparation and serving workers, cafeteria attendants, and cooks for fast food restaurants (http://www.bls.gov/oes/2011/may/oes_nat.htm). Since a large proportion of Hawai'i's jobs are service jobs (roughly 10% in food service), if the wage distribution for unskilled workers in Hawai'i is similar to the country as a whole, then raising the minimum wage may have a larger impact than in other states. Therefore, if Neumark and Wascher are correct, a policy of increasing the minimum wage could sacrifice many unskilled workers in an attempt to raise the living standards of those workers who still have jobs.

As an antipoverty tool the minimum wage is undoubtedly inefficient. There is surprisingly

little correlation between a worker earning the minimum wage and living in poverty (Charles Brown, 1988). Approximately one third of the minimum wage workers in the U.S. are teenagers and not heads of households. Furthermore, most teenagers earning below the minimum wage are not members of poor families. All but one recent study have found that past minimum wage hikes had no effect on poverty.¹ Neumark and Wascher (2002) and Neumark, Schweitzer, and Wascher (2004, 2005) have found that some low-skilled workers living in poor families who remain employed receive higher earnings 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. Card and Krueger (1997) and Burkhouse and Sabia (2007) estimate the effect of state minimum wage increases on state poverty rates. These studies also find no evidence that past minimum wage increases have significantly reduced poverty. Although Card and Krueger found some evidence of falling poverty rates in states with the largest increases in minimum wage, their estimates remain controversial. Only if a larger proportion of Hawai'i minimum wage earners are members of poor households will raising the minimum wage prove successful in improving living standards here.

An obvious question is whether there is a better way to raise the incomes of low-income workers, one that does not raise these concerns. In fact there is: the Earned Income Tax Credit (EITC). The EITC is a refundable federal income

tax credit for low to moderate income working individuals and families. Congress originally approved the tax credit legislation in 1975 in part to offset the burden of social security taxes and to provide an incentive to work. When the EITC exceeds the amount of taxes owed, it results in a tax refund to those who claim and qualify for the credit.

According to a 2007 study by the Congressional Budget Office (CBO), an increase in the minimum wage to \$7.25, as was eventually passed that year, would increase wages by \$11 billion, of which \$1.6 billion would go to poor families. Increasing the EITC for large families and for single people would cost \$2.4 billion, of which \$1.4 billion would go to poor families! The EITC does not directly raise labor costs to businesses, so it does not reduce the demand for unskilled workers. As a result, welfare recipients may be able to find jobs, gain job experience, and go on to earn higher wages as they accumulate skills.

So why increase the minimum wage when an increase in the EITC is a more effective way to eliminate poverty? Clearly in today's environment of fiscal austerity, increased spending to fight poverty has little chance of getting through Congress. And, the EITC, like many government programs, has very high administrative costs. The minimum wage, on the other hand, has practically no administrative costs. Finally, policy makers may see raising the minimum wage as an important symbolic gesture of support to working families. No wonder the minimum wage is a popular tool among policy makers.

¹ 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, junior high school dropouts are older and unlikely to have small children; whereas most antipoverty efforts focus on families with younger children.

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