WOULD AN INCREASE IN THE FEDERAL MINIMUM WAGE HELP OR HINDER SMALL BUSINESS?

HEARING

BEFORE THE

SUBCOMMITTEE ON WORKFORCE, EMPOWERMENT & GOVERNMENT PROGRAMS

OF THE

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WOULD AN INCREASE IN THE FEDERAL MINIMUM WAGE HELP OR HINDER SMALL BUSINESS?

THURSDAY, APRIL 29, 2004

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON WORKFORCE, EMPOWERMENT, AND GOVERNMENT PROGRAMS
COMMITTEE ON SMALL BUSINESS
Washington, D.C.

The Subcommittee met, pursuant to call, at 10:37 a.m. in Room 311, Cannon House Office Building, Hon. W. Todd Akin, [chairman of the Subcommittee] presiding.

Chairman AKIN. Good morning. The Subcommittee will come to order. I will be making an opening statement here, and then we will be hearing from our different panelists.

I just wanted to thank everybody for coming in this morning and know that your time is busy, but we are really looking forward to what you have to share.

The subject of the hearing today is the question on the proposed changes in the federal minimum wage on small businesses and their employees. I would especially like to thank our witnesses who have agreed to testify before this Committee.

The Fair Labor Standards Act of 1938 established a federal minimum wage of 25 cents an hour for most workers. From 1939 to 1997, the maximum wage was raised 19 times. The current basic minimum wage is $5.15 an hour, with a lower wage for tipped employees, certain new hires under the age of 20 and full-time students who work part-time.

Various bills dealing with the federal minimum wage have been introduced during the 108th Congress. Most recently, during Senate consideration H.R. 4, the welfare reform reauthorization legislation, an amendment to raise the federal minimum wage to $7 an hour, an increase of more than 35 percent, was introduced by Senators Boxer and Kennedy.

Debate surrounding any increase in the federal minimum wage usually includes reference by proponents to the benefits that would be derived from any increase to some of our nation's neediest citizens.

All of us here want to help ensure that all Americans are able to advance in a society where opportunity is abundant and prosperity is the norm, but, as we work for these goals, a mandatory wage imposed on the private sector from Washington is not the solution we need, in my opinion.

Although well motivated, the preponderance of evidence suggests that rather than helping them raising the minimum wage actually has an adverse affect on the nation's low income and lower skilled workforce.

A study conducted by the Employment Policies Institute suggests that despite the robust economy at the time, the 1996 minimum wage increase of just 50 cents an hour destroyed approximately 645,000 entry-level jobs. These low skilled citizens are most likely to take these entry level positions and, therefore, are the most adversely affected when these types of jobs are eliminated.

Recent news indicates that our economic recovery is beginning to move into high gear. The report that non-farm payroll employment increased by 308,000 in March reflects our strong economic indicators.

As legislators, it is our responsibility to pursue policies that will continue to expand this economy and encourage job creation and do away with policies that kill jobs. Federal Reserve Chairman Alan Greenspan once said: "The reason I object to the minimum wage is I think it destroys jobs, and I think the evidence on that, in my judgment, is overwhelming."

I have to say that I do agree with Greenspan. Whether it is in good times or bad, pursuing increases in the federal minimum wage costs low skilled and low income Americans their jobs.

I look forward to hearing testimony from each of the panelists today. Before we get started, I would like to give Congressman Tom Udall, and he gets an extra star for coming in when there are no votes. Actually three stars. He is doing very well today. I give him, the Committee's Ranking Member, an opportunity for an opening statement as well.

Tom?

[Chairman Akin's statement may be found in the appendix.]

Mr. UDALL. Thank you, Mr. Chairman, and thank you for the three stars. I always like to get those. No doubt about it.

The importance of the minimum wage is increasingly evident today as an estimated 6.9 million workers rely on it to provide for them and their families. Unfortunately, the fact is that it barely does provide for many of these workers.

Currently set at a rate of $5.15 per hour, a full-time, minimum wage worker earns a little more than $10,000 a year, almost $5,000 less than the $15,000 poverty level for a family of three.

Also troubling are the 2002 Bureau of Labor Statistics figures that showed how many workers actually earned the minimum wage. According to their figures, 570,000 workers were paid minimum wage, while over 1.6 million were paid less.

Our nation's economy cannot afford to be underpaying such a large number of American workers. In addition, many of those individuals who earn the minimum wage usually do not receive employment benefits such as health insurance and pensions.

As discussions regarding raising the minimum wage progress, the rhetoric often heats up about why this cannot or should not be done. We have heard that an increase in the minimum wage lowers employment, that it makes it harder for low skilled workers to find jobs and that low income families will not really reap any benefits.

The bottom line is that American workers deserve a raise, and it is long overdue that they receive one. It has repeatedly been shown that minimum wage increases actually have raised employment or allowed it to remain constant.

In 1991 and 1996 during the debate on the minimum wage, it was suggested that raising it would result in an economic downturn. Once raised, however, the once feared economic downturn never materialized. In fact, it was during this time that our country enjoyed two of the longest economic upswings in our nation's history.

While it is not clear how much the minimum wage increase contributed to this economic surge, I do know this. What is clear is that the negative effects predicted from providing American workers with better wages did not come to pass.

Today we likely also will hear the argument that by increasing the minimum wage we are hurting our nation's small businesses, yet there is still no evidence to indicate that this is true. In fact, some data show that the impact on our nation's small businesses would not be significant.

One such study conducted by the Jerome Levy Institute in 1997 found that the most recent increase in the minimum wage did not affect the majority of small businesses. Ninety percent of the small firms surveyed for their study stated that the increase did not affect their employment or hiring decisions, and the reason is that many U.S. small businesses already pay wages above the minimum wage.

I believe it is time for Congress to step in and authorize an increase in the minimum wage. At a time when we are giving millions of dollars in tax breaks to corporate America, we also need to take into account the hard working families in this country. They, too, deserve to see an increase in their wages, and we must take legislative action to make sure that our nation's hard working families are able to live on today's minimum wage earnings.

Chairman Akin, thank you for holding this important hearing. I also would like to thank the witnesses for coming today, and I look forward to hearing their testimony and yield back.

Chairman AKIN. Thank you.

We are going to now proceed I think pretty much in the order you are seated. Dr. Paul Kersey, Bradley Visiting Fellow in Labor Policy from the Heritage Foundation.

Paul, give me one second. Opening will be five minute statements. Please proceed, Paul.

STATEMENT OF PAUL KERSEY, THE HERITAGE FOUNDATION

Mr. KERSEY. Mr. Chairman, Members of the Committee, I am Paul Kersey; not Dr. Paul Kersey, but Paul Kersey, Bradley Visiting Fellow at the Heritage Foundation. Thank you for inviting me to discuss the economic effects of the minimum wage.

I should say up front that I am speaking for myself today, and my opinions do not necessarily reflect those of the Heritage Foundation.

It is understandable to want to help out poor families, and toward that end it has been suggested that Congress increase the minimum wage from the current $5.15 an hour to $6.65 an hour.

Well, I have good news and bad news for you. The bad news is that increasing the minimum wage will do little to improve conditions for the working poor because relatively fee of the recipients of such an increase are living in poverty. The good news is that the working poor do not necessarily need government help. Research shows that the dead-end job is largely a myth.

This is not to say that the working poor do not have a hard road ahead of them, but for those who persevere it is a road that leads out of poverty. We should not block off that path by making low wage jobs more scarce, which is a likely result of an increase in the minimum wage.

Our analysis of 2003 U.S. Census data shows that of 7.8 million American workers receiving an hourly wage of $6.55 an hour or less, the immediate beneficiaries of a change in the minimum wage, only 15 percent are living in poverty, and over half belong to families earning double the poverty level. One-fifth of low income workers belong to families earning at least $80,000 annually.

In other words, the typical beneficiary of a minimum wage increase will not be a poor father or mother scrambling to keep a family fed, clothed and housed. The recipients of the pay raises demanded under this proposal are at least as likely, if not more so, to already be members of the middle class.

For those low wage earners who are members of poor families, we should not overstate the effects that an increase in the minimum wage will have. Our review of the Census data indicates that fewer than one-quarter of those affected by the proposed new minimum wage work full-time.

In fact, last year Heritage scholars Robert Rector and Rea Hederman looked at the average hours of work performed by adults in poor families and found that a little more than one quarter, 27.8 percent, reported 2,000 hours or more. Two thousand hours would be equivalent to one parent working full-time year-round. Nearly as many families, 27.4 percent, reported no work at all.

Increasing working hours would have a far greater benefit for these families, both immediately and in the long-term, than increasing the minimum wage. Although the minimum wage increase currently proposed may raise family income by as much as 30 percent in the short-term, Rector and Hederman showed that increasing work hours to the equivalent of having one adult working full-time nearly doubles the average income of these families, even after accounting for lost government benefits and increased taxes.

Over the longer term, minimum wage or near minimum wage work can serve as a springboard to better jobs. Unskilled workers may gain new skills or gain a record of reliability that allows them to move on to better paying positions.

Low wage earners frequently show their wages rise quickly. Full-time workers hired at the minimum wage received a median pay increase of 13 percent in their first year. The schedule of increases currently under consideration—first to $5.90, then to $6.65 an hour a year later—is not all that much greater than the pay raises that occur naturally.

Artificially raising wages will cut off this difficult but direct path to greater prosperity for many poor families and will delay the entry of other workers, including youth, into paid work by needlessly increasing the cost of unskilled labor. Employers will not be able to afford to hire as many unskilled workers and will respond by cutting back their services or replacing workers with machinery.

The average estimate by labor economists is that for a 10 percent increase in the minimum wage, employment among those affected drops by five percent. If the minimum wage is increased from $5.15 to $6.65 an hour, demand for unskilled labor could drop by as much as 15 percent in jobs that earn the minimum wage, resulting in the loss of hundreds of thousands of jobs and making it more difficult for poor families to take this escape route out of poverty.

One final thought about poverty. While it is natural to have sympathy for our fellow citizens who work at low-wage jobs and still live in poverty, we should remember that our notion of poverty is this country is relative. Using U.S. Census data, Heritage Foundation scholars examined the living standards of poor Americans and found that the average poor American has a car, air conditioning in his house, at least one color television with cable or satellite television reception, a home that is in decent condition and enough food in the refrigerator.

Poverty in America, especially for those who do not work, is less a matter of material deprivation than of emotional and spiritual loss, the pervading worry that comes from knowing that one is dependent on the arcane determinations of state and federal bureaucrats and the loss of self-esteem that comes from knowing that one is not self-sufficient.

For the working poor, this aspect of poverty is largely abolished. They are able to face the future with optimism and confidence, however modest their income, precisely because it is earned.

Chairman AKIN. Paul, we are just about out of time here. Can you just finish up?

Mr. KERSEY. Certainly. There is really no such thing as a dead-end job. Low-wage jobs provide the poor with an escape route from poverty. It would be a shame if in the name of helping the working poor we made this escape route more difficult for them to follow.

Thank you very much.

[Mr. Kersey's statement may be found in the appendix.]

Chairman AKIN. Thank you for your comments.

Our second witness is Craig Garthwaite. Did I get that right, Craig?

Mr. GARTHWAITE. Yes.

Chairman AKIN. And you are the Director of Research in the Employment Policies Institute.

Thank you. Would you please proceed?

STATEMENT OF CRAIG GARTHWAITE, THE EMPLOYMENT POLICIES INSTITUTE

Mr. GARTHWAITE. Thank you, Mr. Chairman, Members of the Committee, for the opportunity to testify.

Across Capitol Hill today, Senator Ted Kennedy and other supports of a minimum wage hike have brought Hollywood celebrity Ben Affleck to support their cause. While I am a fan of Mr.

Affleck's movies, I am afraid no amount of star power can overcome the economic destruction wrought by a minimum wage increase.

As the Chairman noted, Dr. Greenspan's statement best summarizes the problem with the minimum wage increase. Dr. Greenspan was referring to the decades of economic research from economists at universities such as the University of Chicago, Cornell University and the University of Michigan, which show that an increase in the minimum wage decreases employment.

A 1998 survey by economists at Stanford, Princeton and MIT found that the average economist believes a 10 percent increase in the minimum wage will lead to a 2.1 percent decrease in effective employment.

Overall job loss, however, is not the most insidious employment result from a minimum wage increase. This result is the fact that the job loss is concentrated on the least skilled employees, the very individuals supporters of a minimum wage increase are attempting to help.

These low-skill employees lose their jobs because of increased competition for more experience and higher skilled employees attracted to the new wage. Employers, who already attempt to match productivity to wages to the greatest degree possible, are more than happy to hire these new employees. The end result is that low-skilled Americans face extreme difficulties finding the entry level employment necessary for future economic success.

In 2004, Duke University economists found that this new competition following a wage increase comes primarily from teenagers in wealthy families. Previous research by economists at Cornell, Boston University and Michigan State University found that low-skill employees are pushed out of the labor force in favor of higher skilled teens and others who are perceived as desirable employees.

This loss of low-skill jobs is not a new phenomenon. It dates back to the original minimum wage. The Administrator of the Wage and Hour Division of Franklin Delano Roosevelt's Labor Department wrote in a report to Congress analyzing the original 25 cent minimum wage that "in a number of instances there have been reports that workers who had been receiving less than the new minimum wage had been laid off and replaced by more efficient workers."

Even supporters of increasing the minimum wage admit this point. The union-backed Economic Policy Institute stated that a higher mandated wage will "attract good workers and encourage them to provide high-quality services." In that instance, what happens to the employees previously in these jobs? Where are they supposed to learn the skills that we all learned in our first jobs?

Recently, a small number of studies have been put forth by economists stating that the minimum wage does not decrease and may even increase employment. These studies, primarily conducted by Drs. David Card and Alan Krueger, are a testament to poor survey methodology.

Respected labor economist Finis Welch of Texas A&M University summarized the objections of these studies best when he said: "The consensus view has big problems with Krueger's results and methodology. Alan ought to consider the old saw. If you drop an apple and it rises, question your experiment before concluding that the laws of gravity have been repealed."

The experiment in question in this situation involved poorly trained survey takers utilizing unclear questions that generated inexplicable changes in the data over the time period studied.

Overall, the consensus view of the academy has returned to the fact that increase in the minimum wage does decrease employment, particularly for minorities and poorly educated individuals.

In addition to job loss, the minimum wage is a blunt policy tool unable to discern between a low wage worker who may be from a wealthy family and a low-income family head. According to recent U.S. Census data, only 15 percent of the beneficiaries from a proposed increase in the minimum wage to $7 an hour would be single earners with children. The remaining 85 percent are teenagers living with their working parents, adults living alone or individuals who are married with a working spouse. The average family income for these beneficiaries is $44,000 a year.

These results really should not be surprising. Even former Clinton Labor Secretary Robert Reich admitted that "after all, most minimum wage workers are not poor."

The poor targeting of minimum wage results in the majority of benefits not reaching poor families. Researchers out of Stanford University found that only 24 percent of the benefits from the minimum wage hike go to the poorest 20 percent of the families.

I have spoken quite extensively about what a minimum wage does. It is important to consider what this anti-poverty program does not do. It does not decrease poverty. Research from economists at Ohio University found no connection between a minimum wage and decreased poverty. For some subgroups, the office found that minimum wage could increase poverty.

These findings were predicted by Nobel Prize winning economist Joseph Steigler when he stated that the blunt nature of the minimum wage makes it "an inept device for combating poverty, even for those to succeed in retaining employment."

When individuals work, they are able to leave poverty because of their increased skill level and corresponding wages. As Bill Clinton said: "The best anti-poverty program is still a job."

Recent research at Miami University of Ohio and Florida State found that nearly two-thirds of minimum wage recipients receive a raise within one to 12 months of employment. These raises are non-trivial. Over the past 23 years, the median annual growth in wages for non-minimum wage employees has been nearly six times that of employees earning more than the minimum wage.

The wage growth has even occurred since 1998, a time period during which minimum wage supporters implied the classist notion that low-wage employees have been unable to earn the raises based on their hard work and skill level.

Chairman AKIN. Craig, we are going to need to wrap up here.

Mr. GARTHWAITE. All right. I can wrap up.

Instead of supporting an ineffective anti-poverty tool, policy makers should support strategies that increase entry-level opportunities for low-skill Americans. The earned income tax credit is the most effective anti-poverty program in existence. The credit provides a tax free cash supplement to the incomes of working families while simultaneously creating an explicit incentive for increased work and reducing poverty.

Minimum wage, on the other hand, will not decrease poverty and will limit the employment opportunities of the least skilled Americans. By denying these individuals early entry into the labor force, the minimum wage will push them further into a life of poverty and government dependence.

Thank you.

[Mr. Garthwaite's statement may be found in the appendix.]

Chairman AKIN. Thank you, Craig.

Our next witness is Mr. Todd McCracken. He is president of the National Small Business Association.

Todd? Thank you.

STATEMENT OF TODD MCCRACKEN, NATIONAL SMALL BUSINESS ASSOCIATION

Mr. MCCRACKEN. Thank you, Mr. Chairman. I appreciate the opportunity to be here today. I will attempt to summarize my written statement and make my remarks relatively brief.

Chairman AKIN. Todd, did you want to submit for the record your other comments?

Mr. MCCRACKEN. Yes, I would please.

Chairman AKIN. Without objection.

Mr. MCCRACKEN. The National Small Business Association has represented small businesses since 1937. We work on a bipartisan or nonpartisan basis to do what is best for the small business community.

On this particular issue, we think it is pretty clear that an increase in minimum wage does not serve the small business community, and it does not serve the employees of the small business community either, we do not believe.

To sort of illustrate this point, I would like to use an example. I use an example of a hardware store in my written statement, but I would like to sort of talk about that a little bit and sort of help the Committee understand that increasing the minimum wage is really an exercise in small businesses making choices. That is what it is really all about and about removing one of those choices from the equation.

I mean, if you have a small maybe hardware/lumber store in middle America someplace that has 15 or 20 employees, many of whom are part-time, many of whom are relatively young workers for whom it is their first job in many cases, this is a company that is already having a very hard time staying afloat.

This is a company that is having to compete with the Wal-Mart at the edge of town, having to compete with the Home Depot that just came in. They cannot compete based on price. They have to compete based upon service. They have to compete based upon to some extent community goodwill.

If you increase the minimum wage on these folks, some other people are probably making at or near the minimum wage. Some are not, but what you see is say minimum wage goes up by $2 an hour. You see the minimum wage workers seeing their wages go up.

The people who were making maybe $1 or $2 above minimum wage? Well, they are going to expect their wages to go up $1 or $2 an hour as well, so really the whole wage scale goes up a little bit.

Everyone is making a couple bucks more an hour. That is probably $40,000 or $50,000 a year by the time you add it all up, plus the FICA taxes that I pay on top of that and everything else.

I am already not making enough for my business because of the competition from the big box stores that have come in, so what choices do I have? I cannot electively have the business be less profitable. I may as well close my doors if that happens.

I have to make other choices. What I will do is some of my employees who are full-time employees probably do have a health insurance benefit. Well, when that rate increase comes in next year I am going to pass more of that on to my employees, and they are going to pay a bigger share of their health insurance bill.

I am going to look and see if some people are working 30 hours a week can I get by with them working 25 hours or a week or 20 hours a week. The new kid that I just hired to help out a friend in church who needed some extra money and they are not doing so well and I hired him to sweep floors after school, I cannot afford to do that anymore.

What it does is generate a whole series of other choices and decisions that a small business owner or operator has to make inevitably to continue to run a profitable business, to continue to keep other employees employed and happy.

None of these choices are really ones that I think serve the interests really of most employees. It does not serve really to increase the overall welfare of most of those employees because they wind up making less some other way.

It is our strongly held belief that if we really want to help the working poor there are plenty of tools at our disposal to do that. The federal government has at its disposal rather this very strange, blunt object of a federal mandate in the minimum wage, and we ought to pursue those if we think that folks who are working at low wages need to make more money and not rely on handicapping the small business community in its day-to-day business decision as a way to do that, A, because it does not make sense, and, B, because it does not do that.

That is basically my statement. Thank you.

[Mr. McCracken's statement may be found in the appendix.]

Chairman AKIN. Todd, thank you very much. I appreciate your testimony. You brought it in time, so you get one of the stars here today. You are doing pretty good.

Our next witness is Mike Fredrich. Mike, did you come all the way from Wisconsin today?

Mr. FREDRICH. Yes, I did.

Chairman AKIN. We really appreciate that, Mike. From Manitowoc Custom Molding, LLC. Mike?

STATEMENT OF MIKE FREDRICH, MANITOWOC CUSTOM MOLDING, LLC

Mr. FREDRICH. Thank you, Mr. Chairman, and thank you for inviting me here today. As mentioned, I am the president and owner of what I think would be considered a small business. We have 90 employees. They are non-union employees, and our hourly wages range between $8 and $23.

So why are we here? We do not have anybody that is being paid minimum wage now, so why should we care? Well, we do care. It amazes me when I look at what goes on in Washington out there from the hinterland in the frosty north that there is a total disregard for action and reaction.

In the economy—I call it the physics of business—there is an action and reaction, and the previous speaker, Todd, identified that. We do not have any minimum wage employees, but we start off people at $8 an hour. We are able to fill positions. Not easily, but we do fill them.

If there is an increase in the minimum wage as proposed, and, by the way, we are fighting this in Wisconsin because Wisconsin is trying to do this on their own, so this is not the first time I have testified on this subject. If there is an increase in minimum wage, all the people that we have there at $8 an hour now expect that their wage should go up. Maybe it should. I mean, everybody wants to make more money, and there is a balancing act between running a business that is going to stay in business and make profits and satisfying people's needs.

What happens in Washington is you ignore the other part of what you do. You ignore the reaction. I will just give you an example of our reaction because this is exactly what we will do. If we have a forced increase in our wages, the mandated increase, we have two options which we can look at.

One of which was identified by the previous speaker is our health are. We now have an 80/20 co-pay for our health care for our employees. Everybody is eligible. Our premium for single people is $300, and the premium for families is $800. We pay 80 percent of that every month.

If our wage scale is forced to increase, the first reaction we would have is we are going to change that ratio. We are going to change it to 75, to 70/30, but definitely that scenario we are going to change.

We have tried not to do that over the past two years even though our expenses have increased because it is an important thing for people, and we feel it is our responsibility to try and help people with health care, but it will give us no option. That is one thing we are going to do.

The second thing we are going to do, and we have already done it in some cases, is we are going to outsource production. We have established relationships with companies in China, and in many cases our products are so price sensitive, especially when they go into the retail business and they end up on the shelves of Wal-Mart. It is so price sensitive that a penny increase in our product will force them to outsource, or maybe they will go and have the whole product made in China.

In our case, what we would do is we would outsource the molding for them. We would go to China and say you mold this product for us. We will import it, and we will turn around and sell it. I mean, that is what is happening, and that is what is going to happen in our case.

A third quick example of how the minimum wage will affect the decision that we make. We are going to hire starting on Monday a young man who is a junior in high school. He has great mechanical aptitude. His father works at our company. He is the head of our maintenance.

We are going to bring him in and give him a job, a summer job. He is coming in at the minimum wage, $5.15. He is going to work in the maintenance department. He is going to do all sorts of stuff. It is like cleaning out your closet at home. You just never get around to it. We have all sorts of jobs like that. In the meantime, he can develop some expertise and learn some things.

He is not worth right now $5.15 an hour. I do not know what he is worth, but he is probably not worth anything. We are going to have to train him. By the end of the summer, he will be worth something. He will have learned something. He will have developed some skills. It will be a good thing for him.

Increases like Wisconsin is going to do—they go to $6.80 an hour, which is what they are proposing. He gets no job. He cuts lawns. He does something else, but he does not work at our company.

I have very little time. I will sum this up in saying I look at minimum wage as the $100 or nothing argument. I think it should be $100 or I think it should be nothing. I do not know how many people in this room make $100 an hour, but would it not be great if we all did?

What would happen if we did? We would not have jobs probably, many of us. Maybe you in government would because you could create the money, but in the private sector there would be no jobs.

Anybody who advocates an increase in the minimum wage, why in the heck would they stop at $7? Go to $15. Go to $20. Go to $25 if you really think that is going to help people Then you can ignore the results and just see what happens because it does happen even for a small increase as you are proposing here, which on a percentage basis is not that small.

There is a reaction, and you must understand that you cannot operate in a vacuum.

Chairman AKIN. Mike, we are about out of time.

Mr. FREDRICH. Okay.

[Mr. Fredrich's statement may be found in the appendix.]

Chairman AKIN. You will have a chance to come back around and make some comments as we do the questions.

Mr. FREDRICH. All right.

Chairman AKIN. Thank you for your testimony.

Mr. FREDRICH. Thank you.

Chairman AKIN. Our last witness is Jared Bernstein, senior economist with the Economic Policy Institute.

Jared? You are a doctor. Is that correct?

Mr. BERNSTEIN. That is right.

Chairman AKIN. Good. Thank you. Could you please proceed?

STATEMENT OF JARED BERNSTEIN, ECONOMICS POLICY INSTITUTE

Mr. BERNSTEIN. I sincerely thank the Chair and the Committee for the opportunity to testify on this issue of great importance to working families, and I submit my written comments for the record.

Chairman AKIN. Without objection.

Mr. BERNSTEIN. Congress has long recognized the need for a policy that prevents market forces from driving the wage of our lowest paid workers down below a level deemed to be minimal by both our elected officials and our general sense of fairness and decency.

Since it is not indexed to inflation, the buying power of the minimum wage declines unless our nation's leaders enact an increase. Thankfully, there are a couple of proposals being discussed right now to raise the minimum, and I speak to these specific proposals below.

It is not widely recognized that we as a nation are on track to tie the longest period over which Congress has failed to enact an increase in the minimum wage. The minimum wage was ignored for nine years over the 1980s until George H. Bush signed an increase in 1990. The next increase came under President Clinton in 1996 with bipartisan support from a Republican majority Congress.

Thus, while increasing the minimum wage is often a divisive issue, it is instructive to note that partisans have historically worked together to ensure that the lowest paid among us are not wholly subject to the vicissitudes of the marketplace. The current period is the second longest on record without an increase.

I am now going to refer to a set of charts that I prepared and are submitted for the record. The real minimum currently stands, the minimum adjusted for inflation, at 30 percent below its peak level in 1968 and 14 percent below its level in 1997 when it was last increased.

The importance of that last point is as follows. The inflation that has occurred since the last increase passed in 1996 has now fully eroded its value. That is, in 2004 dollars the minimum wage in 1995 was $5.19 compared to $5.15 today, so the last increase is essentially gone.

The last minimum wage increase in 1996–1997 increased the earnings of about 10 million workers, about nine percent of the workforce. The two current increases under discussion, one to $7 an hour, one to $6.25, would reach far fewer workers, about seven million for the higher one and four million for the lower one, so in this case these are modest proposals.

Now, we have heard a lot about the negative employment outcomes discussed on the panel so far, and this is despite the fact that contemporary economic research casts a long shadow of doubt on this contention. The so-called disemployment argument is particularly difficult to maintain given some recent developments in the history of minimum wages.

First of all, recent studies solidly reject the conventional hypotheses that we have heard discussed thus far, but, secondly, and I think much more importantly as Representative Udall mentioned, following the most recent increase legislated in 1996, the low-wage labor market performed better than it had in decades.

The fact that employment and earnings opportunities of low-wage workers grew so quickly following that increase continues to pose a daunting challenge for those who maintain that the minimum wage hurts its intended beneficiaries.

On the point of small business, there is a recent study which I present in my testimony which shows the outcomes between states with higher minimum wages at the federal level and those who have kept their minimum wage at the federal level for small businesses.

Between 1998 and 2001, the number of small business establishments grew twice as quickly in states with higher minimum wages. Employment grew one and a half percent more quickly, so small businesses, according to these data, have actually performed better in states with higher minimum wages.

We have also heard a criticism of the target efficiency of the minimum wage, the fact that some minimum wage earners reside in high income families. In fact, most of the gains of minimum wage increases flow to those in the bottom third of the income scale. Many of those folks are above the poverty line, but they still need the increase because their incomes are too low for them to make ends meet given the current minimum wage.

We have also heard the EITC, the earned income tax credit, discussed as an important source of income for low-wage workers and a substitute for a minimum wage increase. I show in my testimony that the interaction of the minimum wage and the earned income tax credit is critical for full-time working parents with children.

In fact, after the last minimum wage increase the earned income tax income and the higher minimum wage combined to put a mom with a couple of kids working full-time above the poverty line. That has now eroded to the point that the minimum wage plus the EITC no longer achieves that goal.

If Congress acts to increase the minimum wage in tandem with the earned income tax credit, such families will again be above the poverty line.

Thank you very much.

[Mr. Bernstein's statement may be found in the appendix.]

Chairman AKIN. You did a good job at right exactly there at five minutes.

We are now at a place where we can take a question or two. I would defer to the Minority Member, Mr. Udall. Congressman Udall, if you would like to ask a question?

Mr. UDALL. Thank you, Mr. Chairman.

I guess the first question is directed to Mr. Bernstein. Others on the panel seem convinced that increases in the minimum wage lead to job losses, but you raised the latter 1990s as a period wherein the minimum wage was raised and the low-wage market took off.

In fact, low-income working families saw their incomes rise faster than any time in the past 30 years, and unemployment fell to a 30-year low. Can you help us square these apparently contradictory accounts?

Mr. BERNSTEIN. As I said in my spoken statement, this period poses a daunting challenge for what I would say is the argument most consistently offered by those who oppose minimum wage increases.

In fact, the research on this is solid enough that the consensus among economists has been shifting, particularly due to the work of David Card and Alan Krueger, including pseudo experimental empirical research, which is so rare in economics and provides some of the most convincing research to challenge the notion that moderate increases in the minimum wage reduce employment.

There is no better example than the second half of the 1990s when the minimum wage was increased from $4.25 to $5.15. We heard the exact same arguments that you have heard down this line at this panel, and here we are again hearing the same arguments despite the fact that the employment rates of low-wage workers went up as quickly as they had at any prior point in their history, along with, as you mentioned, their wages and income.

Now, this was not attributed exclusively to a minimum wage hike, and members of the panel and Committee should be aware of that. I am not claiming that you raise the minimum wage and the low-wage labor market begins to boom. What I am claiming is that that evidence is completely inconsistent with the notion that an increase in the minimum wage leads to job losses in the low-wage labor market.

The macro economy, the strength of the macro economy, determines the employment and earnings opportunities of low-wage workers. The minimum wage determines what they get paid.

Mr. UDALL. Thank you.

Mr. Chairman, I do not know whether he put his statement in the record, but I would like to because——

Chairman AKIN. Without objection. Yes.

Mr. UDALL [CONTINUING] Yes. There are some very good charts here. One of them has the inflation adjusted value of the minimum wage from 1947 to 2004.

Now, I am wondering in looking at this in terms of inflation and the minimum wage should the minimum wage try to keep up with inflation? We know that there is less purchasing power for the minimum wage today. If it should try to keep up, why is that, Mr. Bernstein?

Mr. BERNSTEIN. I think there are lots of good reasons for the minimum wage to keep up with inflation. The obvious one is that the chart that you see on the inflation adjusted value of the minimum wage would no longer bip and bop around as Congress and folks like those on this panel had this argument year in and year out.

The way the thing is structured we have to come back and have this battle, and low-wage workers are left behind because their buying power erodes every year. Numerous proposals have been set forth to index the minimum wage, and I think it makes sense in order to both establish a buying power that is not eroded by price decreases and essentially prevents the politization of the issue every few years.

Mr. UDALL. We have seen in terms of wealth distribution a trend shifting towards the wealthy recently. Can you compare the effects of wealth distribution in this country, of tax cuts for higher income people versus an increase in the minimum wage?

Mr. BERNSTEIN. Sure. I have a figure in my testimony. I believe it is Figure 6. This figure shows the distribution of benefits from a minimum wage increase and compares it to the distribution of income.

If you look at families in the bottom decile, the bottom 10 percent of the income distribution, their average income is about $11,000 per year. These are working families. Their average share of the benefits from a minimum wage increase are 30 percent. That is, 30 percent of the gains from the minimum wage go to these low income families whose average income is $11,000.

If you go up to the top end, you will find that in the top 10 percent those families' average income is $181,000 per year compared to $11,000 in the bottom decile. Their share of the gains from the minimum wage increase is about three percent, so some of the gains do leak up to the top, but a very small amount. Meanwhile, you see how skewed the income distribution is.

One of the problems we faced in our current recovery right now, and no less than Greenspan commented on this the other day, is that the growth that has occurred thus far has been concentrated almost exclusively among profits. Compensation has been flat, particularly for those at the low end, and for those earning the minimum wage their earnings fall with inflation year in and year out.

One of the reasons that I stress in my testimony to increase the minimum wage is to essentially give a bit of bargaining power to those at the bottom end who lack that and ensure that some of the benefits of a relatively strong growing economy accrue to those who are helping to promote that growth.

Mr. UDALL. Thank you.

Chairman AKIN. I appreciate the exchange here. I guess maybe I will kind of pick up where you left off.

Mike, I appreciate your comment about when you see an apple fly up in the air you have to start wondering about the laws of gravity. It seems like that it a little bit what we are talking about.

There were a couple of questions that you raised that I think make sense, and that is if a minimum wage of $7 or $8 is good, why is $100 not better? Obviously this is one of those things that apparently if you push it too far something bad is going to happen.

I guess the question for anybody who would like to answer it is let us just say that you do push the minimum wage and say you kick it up to $20 or something. What would be the effect of doing something like that? Anybody want to take a shot at that?

Mr. FREDRICH. I have my light on here, so I will take a swing at it.

It does not have to go to $20. I mean, if it went up 15 percent or 10 percent, any incremental increase will have an inflationary effect on the cost of labor in this country.

Chairman AKIN. First of all, if you raise the minimum wage the cost of labor is going to go up. That seems pretty straightforward.

Mr. FREDRICH. Absolutely. Companies buy labor like you buy grapes or I buy grapes. I was in the supermarket yesterday, and grapes are $2.50 a pound. I am not buying grapes at $2.50 a pound. When they get to 99 cents, I am in the market.

Labor is the same way. Labor gets too expensive. Companies seek alternatives. They will do something else. They will take an action. They have more potential actions to take than the employee does. Their action is to outsource. Their action is to eliminate people. Their action is to reduce their health care, which is what we are going to do.

If you increase a rate to something like $15 or $20, and people talk about living wages, you have increased the cost of doing business in the United States.

Chairman AKIN. Mike, I would just sort of like to break in there.

We have been holding hearings around the country, and one of the things over the period of the last several years, we have been talking to people who have been moving their companies overseas at great cost to communities because the jobs are gone.

The reason that somebody moves their business overseas is strictly money, and the reason they do it is because it is cheaper to make product overseas. One of the things that we have tried to focus on are what are the things that are costly which make us uncompetitive as a nation which make those jobs and businesses go overseas.

If you increase one of the costs of doing business, which is labor, you are creating an incentive to send more jobs and to do the work somewhere where the labor is cheaper. Is that not correct?

Mr. FREDRICH. That is absolutely right. You can look at study after study. You cannot do studies and control all the variables. I mean, it is in a vacuum.

The speaker to my left here quoted a study, but it does not pass the logic test. Just think about it in your own lives. If you increase the price of something, you buy more or less of it. If you create a price for a product or a service that is above the market place, what have you done to the market? You have changed the market.

Now, companies are going overseas and producing overseas because they cannot be competitive here. They still want to stay in business, and I think we still want to have a capitalistic system in the United States.

We are creating overhead burden on our companies by actions just like we are talking about here today. There are many others.

Chairman AKIN. In other words, following the logic that we are talking about, the answer to my original question, which was your question, why not shift the minimum wage to $100, the effect is as you raise it up you are going to get fewer jobs, but the people who do have jobs are going to be very happy because they are making a lot of money, so it is a tradeoff between the number of jobs and how much money people will make.

That is the bottom line, is it not?

Mr. FREDRICH. It is employment versus compensation. If you want to expand employment, my gosh, all the talk in Washington is all the jobs that we have lost.

Our company has added 30 jobs in the last year due in part to the fine work that the Congress has done in lowering our tax burden.

Chairman AKIN. My understanding is that the unemployment rate now is about 5.7, which is about a 50 year average, so while the unemployment is improving significantly month to month—we just had one of the best months ever in March with 308,000 new jobs—still we are looking for that to get even better in the months ahead.

What you are going to do is it is going to cost you on the employment side. You raise minimum wage, you are going to have fewer jobs. It is a tradeoff.

Mr. FREDRICH. Absolutely. It is supply and demand. It is not something we either like or do not like. It is just sort of like the law of gravity. It is what it is.

Chairman AKIN. Did you want to comment on that as well?

Mr. GARTHWAITE. As we talk about the employment rate, I think it is important that we do not just concentrate on the national employment level, which was 5.7 percent, but we start to look at some of the groups that are really going to be affected by minimum wage increases.

You have teenage unemployment in the country right now at 16.5 percent. You have minority teen employment for African-American youth age 16 to 19 that is at 29.4 percent.

There are a lot of things we can do to increase the opportunities for these people to get into the market. Clearly one thing we can do to make sure they do not get a job and that would increase those unemployment rates is to raise the minimum wage.

Chairman AKIN. Thank you very much. We are done with the comments I had.

Mr. UDALL. Thank you, Mr. Chairman.

Mr. Bernstein, on Figure No. 4 in your presentation here you compare proposed minimum wage increases to the 1996–1997 increase. What this chart apparently shows is that the proposed increases compared to these previous increases impact fewer workers.

Could you explain this chart a little bit and what this is really saying and what the relevance to this hearing is?

Mr. BERNSTEIN. Sure. It actually relates to the question that was posed by the Chair.

The minimum wage increase in 1996–1997 reached about nine percent of the workforce. That is, about 10 million workers earned between $4.25 and $5.15 when that increase went into effect, so that is the number of folks who essentially were in the sweep. They were the ones who got a wage increase due to the increase in the minimum.

Right now, because wages have grown over the past seven years—as we discussed earlier, we had a very strong wage growth at the low end—you would need a larger increase if you were going to get that same number of workers in that sweep.

The proposals that are under discussion, they will reach about seven million workers—that is about six percent of the workforce—if you go to $7 and about four million if you go to $6.25, so they will have considerably less reach in that regard.

I think this is important regarding the Chair's question. Nobody is advocating a minimum wage of $20 or $100 per hour of course, but it does raise the question of how high can you go and how high should you go. I think that is a good question.

The economic research is very consistent on this because, as you mentioned in your introduction, we have had 19 minimum wage increases so we have a sense of what kind of impact they have.

If you capture less than 10 percent of the workers in the sweep, and, by the way, historically we have never gone above that rate. If you capture 10 percent or less of the workers in the sweep when you increase the minimum wage, the job loss effects that have been so highly touted by other members of the panel turn out to be immeasurable. You just cannot find them in the data.

The low-wage labor market, despite what we have heard today, clearly absorbs such an increase without disemployment effects, so that is a good guideline when Congress is considering how high to raise the minimum.

You would not want to go above a level that is going to capture more than 10 percent of workers in the sweep, and the two increases that are under discussion pass that test quite easily.

Mr. UDALL. Thank you. Now, the issue seems to be raised that raising the minimum wage would push us to outsourcing overseas. Do you agree with that proposition, and do other countries not have a minimum wage, and how does that relate with minimum wages around the world?

Mr. BERNSTEIN. Well, some countries do and some do not. Certainly I am not aware of a minimum wage in China, although minimum wages in Europe are consistent with ours, if not higher.

I think the important thing to think about there is that I think it is an extremely dangerous road to go down if we are thinking we need to make sure we keep the minimum wage low enough so that we can compete with China and Mexico. That to me is a race to the bottom like you have never seen before.

One of the critical aspects of the Fair Labor Standards Act introduced in the beginning of this hearing is that it sets a wage floor below which Congress deems we should not pay our lowest wage workers.

In this sense, it is an expression of a social policy as much as an economic policy and one that says we as a country agree that the benefits of productivity growth, which have been prodigious in this recovery, should be at least partially shared with all the bakers of the growing pie, not just those at the top.

The notion that we have to damp down the minimum wage so we can be competitive with workers in China strikes me as an extremely dangerous path to hoe.

It is also notable, by the way, that the jobs that are currently being outsourced pay far more than the minimum wage if we are talking about IT and high tech jobs. The same thing for manufacturing. Those jobs in this country pay well over $20 an hour, so that is not really germane.

Mr. UDALL. Thank you very much, and let me thank the entire panel for their testimony today.

Thank you, Mr. Chairman.

Chairman AKIN. Thank you.

Just a couple miscellaneous thoughts here. First of all on the whole question of minimum wage. Does anybody know whether this has ever been viewed from a constitutionality point of view?

I mean, just from the logic that if you, Mike, are a businessman and somebody is working for you, usually the way that freedom works is that you allow the employee and the employer to come to some agreement, and you make a deal. I will work for you if you pay me his much an hour. That is kind of the way freedom works.

What we are doing here though is we are saying but, Mr. Employer, you cannot do that. Freedom is not going to work that way. We are going to tell you how much you have to pay, which, of course, then makes it completely uneconomic to hire somebody who is worth less than whatever the minimum wage is. Therefore, you lose the benefit of some employee that otherwise is unemployable. If you cannot hire him for a low wage, you are just not going to hire him at all.

Does anybody question the constitutionality of the government weighing in and telling in the free market people what you have to pay for labor? Has that ever been viewed?

Mr. KERSEY. I believe that question was taken up during the Great Depression. I forgot the name of the precise case, but that question did come up in a number of cases during the Great Depression, and it was decided that yes, government could regulate in this area.

It is also worth noting that———.

Chairman AKIN. I wonder what part of the Constitution they cited?

Mr. KERSEY. It probably would have been the commerce clause. Generally there has been an expansion of the federal government's ability to regulate interstate commerce to the point where it is no longer even necessary that the actual commerce be across state lines.

For better of or worse, it appears that we are in a position where the federal government does have the power to regulate these areas.

Chairman AKIN. Okay. I think that one other thing I might comment on if I was taken out of context. What we have seen is that across the board businesses have expenses in this country. One of the expenses is labor. Another one is health care. Another one is red tape. Another one is taxes. All of those things together make up a cost of doing business in America.

The reason that jobs are going overseas is because we are not competitive quite simply, so from the objective of taking a look at labor costs we are not trying to compete with China on an hour-to-hour, what-does-it-cost-for-labor. That is not the point.

The point is we are trying to compete when you add all of our costs with all of their costs, so when you effectively talk about increasing minimum wage what you are doing is you are increasing our cost. Somebody who does not want to see our cost increase does not necessarily mean that you are trying to compete with China for the lowest wage.

Another question I suppose would be it seems that if you have an automatic increase in minimum wage it is the equivalent of an automatic tax on businesses in a sense.

I guess the other question I have is the overall not-so-easy to measure effect that when you drive the lower cost up, does that not drive every other wage up? I think some of you mentioned that.

I guess our time here has pretty much expired. I appreciate you all coming in today. We will stick around for a minute or two if people have questions or answers or whatever, but thank you for the productive hearing.

The Committee is closed.

[Whereupon, at 11:35 a.m. the Subcommittee was adjourned.]

OPENING STATEMENT
29 APRIL 2004

SUBCOMMITTEE CHAIRMAN W. TODD AKIN
SUBCOMMITTEE ON WORKFORCE, EMPOWERMENT & GOVERNMENT PROGRAMS

Would an Increase in the Federal Minimum Wage Help or Hinder Small Businesses and their employees?

Good morning. I'd like to thank you all for joining us here today as we examine the effect of proposed changes in the federal minimum wage on small businesses and their employees. I would especially like to thank our witnesses who have agreed to testify before this committee.

The Fair Labor Standards Act of 1938 established a federal minimum wage of twenty-five cents an hour for most workers. From 1939 to 1997, the minimum wage was raised nineteen times. The current basic minimum wage is $5.15 an hour, with a lower wage for tipped employees, certain new hires under the age of twenty and full-time students who work part-time.

Various bills dealing with the federal minimum wage have been introduced during the 108th Congress.

Most recently, during Senate consideration of HR 4, the Welfare Reform Reauthorization legislation, an amendment to raisé the federal minimum wage to $7.00 an hour - an increase of more than 35 percent - was introduced by Senators Barbara Boxer and Edward Kennedy.

Debate surrounding any increase in the federal minimum wage usually includes reference by proponents to the benefits that would be derived from any increase to some of our nation's neediest citizens.

All of us here want to help ensure that all Americans are able to advance in a society where opportunity is abundant and prosperity the norm. But as we work for those goals, a mandatory wage, imposed on the private sector from Washington, is not the solution we need.

Although well-motivated, the preponderance of evidence suggests that rather than helping them, raising the minimum wage actually has an adverse affect on the nation's low-income and low-skilled workforce.

A study conducted by the Employment Policies Institute suggests that, despite the robust economy at the time, the 1996 minimum wage increase of just fifty cents an hour destroyed approximately 645,000 entry-level jobs. Our low-skilled citizens are most likely to take these entry-level positions and therefore are those most adversely affected when these types of jobs are eliminated.

Recent news indicates that our economic recovery is beginning to move into high gear. The report that non-farm payroll employment increased by 308,000 in March reflects other strong economic indicators.

As legislators, it is our responsibility to pursue policies that will continue to expand this economy and encourage job creation and do away with policies that kill jobs. Federal Reserve Chairman Alan Greenspan once said, "The reason

I object to the minimum wage is I think it destroys jobs, and I think the evidence on that, in my judgment, is overwhelming." I agree with Chairman Greenspan. Whether in good times or bad, pursuing increases in the federal minimum wage costs low-skilled and low-income Americans their jobs.

I look forward to hearing testimony from each of the panelists today. But, before we get started, I would like to give Congressman Tom Udall, the Committee's ranking member, an opportunity for an opening statement.

Testimony of

Paul Kersey

Bradley Visiting Fellow

The Heritage Foundation
214 Massachusetts Avenue, N.E.
Washington, D.C. 20002

Before the House of Representatives; Small Business Committee; Subcommittee on Workforce, Empowerment, and Government Programs

Regarding

The Economic Effects of the Minimum Wage

April 29, 2004

Mr. Chairman, members of the Committee, I am Paul Kersey, Bradley Visiting Fellow at the Heritage Foundation. Thank you for inviting me to discuss the economic effects of the minimum wage. I should say up front that I am speaking for myself today, and my opinions do not necessarily reflect those of the Heritage Foundation.

Ladies and gentlemen, it is understandable to want to help out poor families, ,and toward that end it has been suggested that Congress increase the minimum wage, from the current $5.15 an hour to $6.65 an hour.

Well, I have good news and bad news for you. The bad news is that increasing the minimum wage will do little to improve conditions for the working poor. This is because relatively few of the recipients of such an increase are living in poverty. The good news is that the working poor do not necessarily need government help. Research shows that the "dead-end job" is largely a myth.

This is not to say that the working poor do not have a hard road ahead of them, but for those who persevere it is a road that leads out of poverty. We should not block off that path by making low-wage jobs more scarce, which is a likely result of an increase in the minimum wage.

Our analysis of 2003 U.S. Census data shows that, of 7.8 million American workers receiving an hourly wage of less than $6.65 an hour—the immediate beneficiaries of a change in the minimum wage—only 15 percent are currently living in poverty. Nearly three-quarters of these workers, 72 percent to be precise, have a family income that is at least 50 percent higher than the poverty line, and over half belong to families earning double the poverty level. One fifth of low-income workers belong to families earning over $80,000 annually.[1] The average family income of the typical low-wage worker was a respectable $40,000 per year.

In other words, the typical beneficiary of a minimum wage increase will not be a poor father or mother scrambling to keep a family fed, clothed, and housed. The recipients of the pay raises demanded under this proposal are at least as likely, if not more likely, to already be solid members of the middle class.

For those low-wage earners who are members of poor families, we should not overstate the effects that an increase in the minimum wage will have. Our review of the Census data indicates that fewer than one-quarter of those affected by the proposed new minimum wage work full-time. There is no reason to believe that this percentage is higher for poor families. In fact, last year Heritage scholars Robert Rector and Rea Hederman looked at the average hours of work performed by adults in poor families, and found that a little more than one quarter, 27.8 percent, reported 2,000 hours or more. Two thousand hours would be equivalent to one parent working full-time year-round. Nearly as many families, 27.4 percent, reported no work at all. Median hours worked by

[1] Data tabulated using the March 2003 Current Population Survey.

adults in families with children were lower than 1,000 per year, or less than 20 hours a week.[2]

Consequently, the value of a minimum wage increase for poor families is limited by the low amount of hours that parents in poor families actually tend to work. Increasing working hours would have a far greater benefit for these families, both immediately and in the long term than increasing the minimum wage. Although the minimum wage increase currently proposed may raise family income by as much as 30 percent in the short term, Rector and Hederman showed that increasing work hours to the equivalent of having one adult working full time nearly doubles the average income of these families, even after accounting for lost government benefits and increased taxes.

Over the longer term, minimum-wage or near–minimum wage work can serve as a springboard to better jobs. Unskilled workers may gain new skills, or gain a record of reliability, that allows them to move on to better-paying positions. Low-wage earners frequently see their wages rise quickly: Researchers at two universities, Florida State and Miami of Ohio, found that full-time workers hired at the minimum wage received a median pay increase of 13 percent within their first year, which shows that low-wage employees are able to work through minimum wage jobs into better ones.[3] The schedule of increases currently under consideration, first to $5.90 then $6.65 an hour a year later, is not all that much greater than the pay raises that occur naturally.

Simply finding full-time work, including jobs at or near the minimum wage, provides the poor with the means to escape poverty. Research by the Employment Policy Institute shows 47 percent of families living below the poverty line in 1997 managed to make it over the poverty line in 1998. The authors of that study concluded that "earnings from minimum wage work and the Earned Income Tax Credit both significantly reduced the number of working poor in the 1990s."[4]

Artificially raising wages will cut off this difficult but direct path to greater prosperity for many poor families, and will delay the entry of other workers, including youth, into paid work by needlessly increasing the cost of unskilled labor. Employers will not be able to afford to hire as many unskilled workers, and will respond by cutting back services or replacing workers with machinery.

Labor economists refer to the "elasticity" of demand for labor to describe the ratio of jobs gained or lost when wages change. Estimates of this "elasticity" vary, but the average estimate by labor economists is that for a 10 percent increase in the minimum wage,

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[2] Robert Rector and Rea Hederman, "The Role of Parental Work in Child Poverty," Heritage Foundation Center for Data Analysis Report No. 03-01, January 27, 2003.
[3] William Even and David MacPherson, "Rising Above the Minimum Wage", Employment Policies Institute, January 2000.
[4] John Formby, John Bishop, and Hoseong Kim, *The Economic Well Being of Low-Income Working Families*, Employment Policies Institute, March 2002.

employment among those affected drops by 2 percent.[5] If the minimum wage is increased from $5.15 to $6.65 per hour, demand for unskilled labor could drop by as much as 6 percent in jobs that earn the minimum wage, resulting in the loss of hundreds of thousands of jobs and making it more difficult for poor families to take this escape route out of poverty.

One final thought about poverty. While it is natural to have sympathy for our fellow citizens who work at low-wage jobs and still live in poverty, we should remember that our notion of poverty is relative. Using U.S. Census data, Heritage Foundation scholars examined the living standards of poor Americans and found that the average poor American has a car, air conditioning, at least one color television along with cable or satellite TV, a home that is in decent condition and enough food in the refrigerator.[6] Poverty in America, especially for those who do not work, is less a matter of material deprivation than of emotional and spiritual loss, the pervading worry that comes from knowing that one is dependent on the arcane determinations of state and federal bureaucrats, and the loss of self esteem that comes from knowing that one is not self-sufficient.

But for the working poor, this type of poverty is largely abolished. They are able to face the future with optimism and confidence, however modest their income, precisely because it is earned. They know they are contributing to the national economy and have taken control over own lives.

Increasing the minimum wage will do little to improve the conditions of poor Americans. Relatively few of those workers who receive wages at or near the minimum are members of poor families. For those poor who are working, wage increases are substantial and come quickly as they accumulate job experience. Increasing the minimum wage will, however, eliminate entry-level jobs for unskilled workers, making it more difficult for those who want to work to find jobs.

There is no such thing as a dead end job. Low-wage jobs provide the poor with an escape route from poverty. It would be a shame if, in the name of helping the working poor, we made this escape route more difficult for them to follow.

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[5] Victor Fuchs, Alan Krueger, and James Poterba, "Economists' Views About Parameters, Values, and Policies: Survey Results in Labor and Public Economics," *Journal of Economic Literature*, Vol. 36, (September 1998) pp 1387-1425.
[6] Robert Rector and Kirk Johnson, "Understanding Poverty in America," Heritage Foundation *Backgrounder* No. 1713, January 5, 2004.

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Testimony of
Craig Garthwaite
Director of Research, Employment Policies Institute
Before Subcommittee on Workforce, Empowerment, and Government Programs
Hearing titled "Minimum Wage and Its Effects on Small Business"
April 29, 2004

Overview

Sixty-five years ago, pharmacies stocked mercury, heroin, and radon as remedies; few people believed that a fungus-based drug called penicillin could cure anything; and the minimum wage was considered our most effective anti-poverty policy. Doctors prescribing mercury today would lose their license, yet the popularity of similarly counterproductive minimum wage increases endures—despite the existence of proven and successful means of addressing poverty.

The impending national elections, combined with the superficial appeal of a minimum wage increase, has led a number of vocal pundits, policymakers and so-called "experts" to clamor for an increase in the minimum wage. The proposed increase will not only fail to reduce poverty, but also it will decrease employment opportunities for low-skill Americans—denying many of them the opportunity to stay in the workforce and learn the skills necessary to improve their lives.

Employment Loss

Federal Reserve Chairman Alan Greenspan best summarized the problem with increasing the minimum wage when he stated **"[t]he reason I object to the minimum wage is I think it destroys jobs, and I think the evidence on that, in my judgment, is overwhelming."**[1] Dr. Greenspan was referring to the decades of economic research proving that an increase in the minimum wage leads to overall job loss for affected employees, particularly the least skilled. While opinions may vary among economists as to the severity of the impact, the overall message couldn't be clearer.

The following is a small sampling of the independent research concerning minimum wages:

- In a 2000 study, economists at Cornell University, the University of Connecticut and the Urban Institute found that **a 10% increase in the minimum wage causes a 2% to 6% decrease in teenage employment**, a common indicator of entry-level employment.[2]

- In 2003, Federal Reserve economists reiterated this finding when they showed a 2% to 3% decrease in employment results from a 10% increase in the minimum wage.[3]

- A 1998 survey conducted by economists at Stanford, Princeton, and the Massachusetts Institute of Technology found that the **average economist believes a**

10% increase in the minimum wage causes a 2.1% decrease in teenage employment.[4]

- An evaluation of the 1990-91 minimum wage increase by economists at the University of Chicago and Texas A&M revealed significant reductions in teenage employment. Employment of teenage males fell 5% after the wage hike, while employment of teenage females fell 7%.[5]

Low-Skill Employment Loss

Overall job loss, however, is not the most insidious employment result from a minimum wage increase. The most damaging effect is the fact that **job loss is concentrated on the least skilled employees**—the very individuals supporters of a minimum wage increase are attempting to help. These low-skill employees lose their jobs because of increased competition from more experienced and higher skilled employees attracted to the new wage. Employers—who attempt to match productivity to wages to the greatest degree possible—are more than happy to hire these new employees. The end result: low-skill Americans face extreme difficulty finding the entry-level employment necessary for future economic success.

In 2004, Duke University economists found that this new competition following a wage increase comes primarily from teenagers in wealthy families entering the labor market and competing with current employees for their jobs. This new competition results in a 2.9% decrease in the probability of finding a job for every 10% increase in the mandated wage.[6] While there is no inherent problem with these teens working, one must question the efficacy and equity of a policy that takes jobs from current employees and redistributes them to affluent teenagers who did not even work at the previous minimum wage.

Earlier research at Cornell University, the University of Connecticut, and the Lewin Group found that vulnerable groups such as young adults without a high school degree, young black adults, black teenagers, and all teenagers suffered significantly more employment loss as a result of a minimum wage increase. For example, the authors found that a 10% increase will result in an 8.5% decrease in employment for black young adults and black teenagers. **This is over four times the employment loss expected for non-black adults and teenagers.**[7]

A Boston University study found that low-skill adults in states that raise their minimum wage are often crowded out of the job market by teens and students.[8] This finding was supported by research from Michigan State University, which found that high-skilled teens, or those who are perceived as "desirable" employees, often displace low-skill employees in minimum wage jobs after a mandated wage hike.[9]

In a cruel twist of fate, University of Wisconsin researchers found that this displacement effect is often concentrated on welfare participants attempting to work their way off of government assistance. **Mothers in states that raised their minimum wage remain on**

public assistance an average of 44% longer than their peers in states where the minimum wage remains unchanged. [10]

The loss of low-skill jobs is not a new phenomenon; it dates back to the original minimum wage. The administrator of the Wage and Hour Division of Franklin D. Roosevelt's Labor Department wrote, in a report to Congress evaluating the $0.25 minimum wage, that **"in a number of instances there have been reports that workers who had been receiving less than [the new minimum wage] had been laid off, and replaced by more efficient workers."**[11]

Even supporters of increasing the minimum wage admit this point. The liberal, union-backed Economic Policy Institute stated that a higher mandated wage will "attract good workers and encourage them to provide high-quality services."[12] In that instance, what happens to the employees previously in these jobs? Where are they supposed to learn the skills we all learned in our first jobs?

Studies Purporting No Employment Loss

Recently, a small number of studies have been put forth by economists stating that the minimum wage does not decrease, and may even increase, employment—a result that cannot be explained under the competitive model that has served as the basis for economic thought over the last two hundred years.

These studies, primarily conducted by Drs. David Card and Alan Krueger, are a testament to poor survey methodology and their results have therefore been discredited by most economists. Respected labor economist Finis Welch summarized the objections best when he said, **"The consensus view has big problems with Krueger's results and methodology.** Alan [Krueger] ought to consider the old saw: If you drop an apple and it rises, question your experiment before concluding that the laws of gravity have been repealed."[13] In this case, the experiment involved poorly trained survey takers utilizing unclear questions that generated unexplainable change in the data over the time period studied.

Where Do The Jobs Go?

You may often hear individuals ask for "real life" evidence of job loss for these low-skill employees. To find such evidence, one need look no further than the double digit unemployment rates facing our nation's most vulnerable employees. While national unemployment was 5.7% in March, **teenage unemployment was 16.5%, and black teenage unemployment was a shocking 29.4%.** Nobel prize-winning economist Milton Friedman explained these high unemployment rates when he stated, "the high rate of unemployment among teenagers, and especially black teenagers, is both a scandal and a serious source of social unrest. Yet it is largely a result of minimum wage laws." Nationwide unemployment rates of this level would cause panic and calls for drastic action. Policymakers, however, are contemplating a minimum wage hike that would only increase unemployment for these groups.

Minimum wage increase advocates claim that job loss does not exist because businesses must hire employees in order to operate. It is true that employers who remain in business—and keep in mind that those businesses who must close their doors as a result of this policy will not fit into this category—cannot simply stop hiring employees. They have and will continue to respond to minimum wage increases by upgrading the skill level of their employees and/or changing the nature of customer service in an attempt to hold down labor costs.

For example, after a wage hike employers seek to take fewer chances on individuals with little education or experience. While the government can mandate how much entry-level employees must be paid, they cannot determine who will be hired at these wages. After each mandate wage hike, employers are newly encouraged to hire the most efficient employee available in an attempt to decrease staff size and related labor costs.

Employers will also look to automate services wherever possible. Self-service gas stations, automated phone operators, automatic teller machines, self-service soda fountains, and self-check out lanes are markers for disappearing of jobs that were once held by low-skill, entry-level individuals. In these positions, employees were once able to gain the skills necessary to improve their future earnings.

Finally, employers will simply cut back on some customer services. It is common for customers at fast food restaurants to bus their own tables. Baggers at many grocery stores have been eliminated. Forced to pay high mandated wages, employers are choosing to cut back on services rather than raise prices. This results in fewer opportunities for low-skill Americans.

Longer Term Effects From Minimum Wage Increase

As these entry-level jobs disappear they take with them a critical gateway into the labor force for low-skill Americans with little or no experience. Former Senator and Democratic Presidential Candidate George McGovern once asked, "Unfortunately, many entry-level jobs are being phased out as employment costs grow faster than productivity ... **when these jobs disappear, where will young people and those with minimal skills get a start in learning the 'invisible curriculum' we all learn on the job?"**[14] Recent research reveals that failing to absorb this "invisible curriculum" causes individuals to suffer significant economic consequences for years after their spells of unemployment.

Economists at the University of North Carolina found that teenage unemployment can decrease future earnings as far as four years into the future. Current unemployment also increases the likelihood that an individual will be unemployed in the coming years.[15] This research documenting the long term effects of the minimum wage illustrates the importance of employment early in one's working years.

Loss of Benefits

Those lucky enough to retain their jobs after a minimum wage hike don't receive nearly the benefit you would expect. The low-income adult employee who gets a pay raise often lose government benefits like Earned Income Tax Credit (EITC) payments, food stamps, and low-cost health insurance. In many cases, the mythical "raise" an employee receives as a result of a minimum wage hike is largely eaten up by increased taxes and lost benefits.

Separate studies out of New York University Law School and the University of Kentucky found that many beneficiaries of a minimum wage increase face effective tax rates of 90% on increased wages.[16] In other words, **many low-wage employees could receive only 10 cents of every new dollar resulting from a minimum wage increase.**

Who Benefits from A Minimum Wage Increase?

In addition to decreasing job opportunities and failing to provide significant benefits to many intended beneficiaries, the minimum wage is poorly targeted and provides the majority of benefits to non-poor individuals. It is a blunt policy tool, unable to discern between a low-wage employee and a low-income family head. As a result, the majority of beneficiaries of a minimum wage increase are not the "poster-child" single family heads living in poverty. **Research from Syracuse University shows that 83% of the benefits from the last minimum wage hike went to families above the poverty line.**[17]

According to recent United States Census data, **only 15% of the beneficiaries from an increase in the minimum wage to $7.00 an hour would be single earners with children**. The remaining 85% are either teenagers living with their working parents, adults living alone, or are married with a working spouse. **The average family income for these beneficiaries is over $44,000 a year.** Furthermore, the majority do not work full-time and nearly a quarter work fewer than 20 hours per week.[18]

The poor targeting of a minimum wage results in the majority of benefits not reaching poor families. Research out of Stanford University found that only 24% of the benefits from a minimum wage hike go to the poorest 20% of families, while 35% of the benefits go to the richest 40% of families.[19]

These results should not be surprising, even former Clinton Labor Secretary Robert Reich admitted that "after all, most minimum wage workers aren't poor."[20]

Minimum Wages and Poverty

Economic research clearly shows that the minimum wage, a supposed anti-poverty policy, does not actually decrease poverty. **Research from economists at Ohio University found no connection between a minimum wage increase and decreased dependency.** Examining state level minimum wages, these economists found no significant connection between a minimum wage above the federal level and decreased poverty. For some sub-groups, the authors found that the minimum wage could increase poverty.[21]

These findings were reiterated by noted minimum wage economist Dr. David Neumark when he stated, **"On balance, we find no compelling evidence supporting the view that minimum wages help in the fight against poverty."**[22] The reason for this is that despite the number of people that may be moved out of poverty, job loss pushes even more people into poverty. On net, dependency is not reduced. But, labor groups who will benefit from a general increase in market wages continue to push for these ineffective policies.

Importance of Employment

Economic research clearly shows that the disemployment effects and poor targeting of the minimum wage makes it an ineffective poverty-fighting tool. Furthermore, with seven out of eight people who are living in poverty either not working or not working full time, it is clear that employment is the best solution we have to poverty. **Even President Clinton acknowledged this when he stated, "the best anti-poverty program is still a job."**[23] When individuals work, they are able to increase their skill level and corresponding wages.

Recent research from Miami University of Ohio and Florida State University found that **nearly two-thirds of minimum wage recipients receive a raise within 1-12 months of employment**. These raises are non-trivial. Over the past 23 years, the median annual growth in wages for minimum wage employees has been **nearly six times that of employees earning more than the minimum wage**. While minimum wage employees have enjoyed significant wage growth over the past decades, this wage growth has been even higher since 1998. Between 1998 and 2002—a time period during which minimum wage supporters insinuate that minimum wage employees received no raise—median wage growth averaged 10.4 percent for employees hired at the minimum wage compared to only 1.7 percent for workers earning above the minimum.[24]

Despite significant wage growth, a small cohort of entry-level employees is unable to acquire the skills necessary to increase their wages. While some may believe these individuals are the justification for a wage increase, the economic reality of the situation is that after a wage increase these low-skill individuals will be the first to lose job opportunities to higher skilled and more experienced applicants.

Earned Income Tax Credit

Instead of supporting an ineffective anti-poverty tool, policy makers should support strategies that increase entry-level opportunities for low-skill Americans. The EITC is the most effective anti-poverty program in existence. This credit provides a tax-free cash supplement to the incomes of working families while simultaneously creating an **explicit incentive for increased work effort.** Since the EITC is not available to those without a job, it provides an unambiguous incentive to work.

With its emphasis on work, it is unsurprising that the EITC increases employment. But it does more than that. Research from economists at Michigan State University and the Federal Reserve found that recipients of the EITC increase their work effort and enjoy higher earnings, moving these employees closer to self-sufficiency.[25] The EITC is the only program that accomplishes this dual goal of improving the earned income of recipients while still providing cash assistance. That may be why Dr. Jeffrey Grogger of UCLA stated that "the EITC may be the single most important policy measure for explaining the decrease in welfare and the rise in work and earnings among female-headed families in recent years."[26]

If policymakers are truly serious about providing workable solutions to poverty, they should examine modifications and extensions of the EITC that provide even greater returns through better targeting. These policy changes would actually improve the living conditions of working families in America.

A minimum wage, on the other hand, will not decrease poverty and will limit the employment opportunities of the least skilled Americans. By denying these individuals early entry to the labor force, the minimum wage will push them further into a life of poverty and government dependence.

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NSBA
National Small Business Association®

TESTIMONY OF TODD MCCRACKEN
PRESIDENT OF

THE NATIONAL SMALL BUSINESS ASSOCIATION

"Would an Increase in the Federal Minimum Wage Help or Hinder Small Businesses?"

Before the House Small Business Subcommittee on Workforce, Empowerment, and Government Programs

April 29, 2004

Good morning. My name is Todd McCracken and I am the president of the National Small Business Association. NSBA is the nation's oldest nonpartisan small business advocacy group reaching more than 150,000 small businesses. I am pleased to be here today representing those companies and would like to thank you, Chairman Akin for giving small businesses the necessary avenue for voicing our concerns over minimum wage increase proposals.

We all know the numbers on small business: small firms comprise more than 99.7 percent of all employers. We employ more than half of all private sector employees and pay 44.5 percent of total U.S. private payroll. Small businesses generate two-thirds of net new jobs annually and make up 97 percent of all identified exporters. However the last 3 years have been tough – we've seen months and months of job losses, health care costs are skyrocketing and fierce competition from overseas. What we need from government is policies that will help small businesses grow, not one that would adversely impact small businesses.

Minimum wage is an important issue to many small businesses. While it is not an issue resolutely held in the same esteem as health care is these days, it is a debate that is garnering sideways glances from those in the small business community. By sideways glances, I mean to imply that many of us are wondering "What are they thinking?" when we see time and again this debate arise. That general sentiment among small business owners is elevated due to the current state of our economy.

Read one newspaper any day for the last year, and I can almost guarantee you'll read something about at least one of the following: economic downturn, manufacturing jobs being outsourced to China, high-tech call-centers moving to India and job losses. If even one of these were a stand-alone phenomenon today, I'd question the sensibility of a minimum wage debate, but especially now that we're dealing with all of these problems, the movement towards a minimum-wage hike seems nonsensical.

As many of the experts on this panel have told you, the overall benefits to increasing minimum wage are nowhere close to outweighing the costs to small businesses. The noble goal of minimum wage increases is to bring aid and relief to America's working poor. However, contrary to what some are saying, minimum wage workers are rarely permanent minimum-wage workers. It is important to understand exactly who we are talking about. According to the Bureau of Labor Statistics (BLS), only 3 percent of workers in the U.S. are paid minimum wage, and only 1.5 percent are full-time employees. Of that 3 percent, only 15 percent were charged with supporting a family. Our friends at the Employment Policies

Institute estimate that of all workers aged 30 and above, only 2.8 percent are at the minimum wage level. EPI also tells us that the average income for minimum wage families increased 30% in one year.

So what do all these numbers tell us? Minimum wage workers are generally young, part-time employees without families to support. These workers see significant growth in their pay and are rarely long-term minimum-wage earners. A minimum wage hike would not bring relief to America's working poor. A survey compiled by BLS in 2000 stated that 80 percent of people below the poverty line pointed to unemployment or under-employment as the cause for their economic distress. The problem isn't low wages, as we've heard, it's unemployment. The quite noble goal of reducing the ranks of families at or under the poverty level would only be exacerbated by a minimum wage increase.

So while some in Congress are assiduously pushing for a minimum wage increase, I'd like to share with you the implications this would have from a small business-owner's perspective. Let's take the example of a small-town hardware store. I hire predominantly high school students to work in the store part-time. I also have a few full-time employees that have been with me for several years. I am currently paying the new part-time hires $ 5.15 as federally mandated, but if the employee is a good worker, I will most likely give him or her a raise in 3 to 6 months. Chances are that I live down the street from this employee's parents, or that one of the full-time employees is a relative of mine. My profits are relatively low because I am not the only hardware store in town, but I'm comfortable. It is in my best interest to treat my employees well, not only to get the best work-product out of them, but also as a connected part of the community.

My story is quite similar to most of the other small businesses in the community. Now if the federal government tells us that we have to increase the hourly minimum wage from $5.15 to $7.00, that's going to directly affect probably 20 percent of my workforce. If we assume that those 10 workers each work 20 hours per week, that's an additional $370.00 per week, which doesn't sound like a huge amount. Well, if we're also to assume that I have the rest of my workers on a graduated scale, it's reasonable that not all would be above $7.00 per hour. So now I'll have to increase those workers to at least the federal minimum, but that's not where I'd stop. Certainly an employee that was making a dollar above the starting minimum wage would expect to still be on that graduated pay-scale. So by making a "simple" change to the minimum wage, the federal government has forced me to increase all my employees' pay by a minimum of $1.85. This would equate to upwards of $2,000 weekly in mandated payroll increases. With my very low profit rates, I will likely make employment adjustments to counteract these stark increases.

At this point, it is unlikely that I'll hire any new people. Rather, I'll do my best to reduce the hours people are currently working. Now keep in mind that I live in this community, I hire kids from the high school where my daughter attends school, and my in-laws work in the business. I'm not a greedy corporate interest trying to exploit my workers. I'm trying to keep my doors open for business so that I can make a living, so that I can keep my workers employed. A minimum wage increase doesn't help the poor in my community, it actually creates situations where some employees may have to be laid off simply because I can't afford to keep all of them.

As the president of NSBA, I must tell you that any minimum wage increase would be a problem for our members. Not because they're greedy and want larger profit margins, not because they all hire minimum wage workers, and not because they want the government out of their lives. It will be a problem for all our members because minimum wage increases are by their very nature inflationary. I implore you and all in Congress to seriously consider the negative implications this kind of unsound economic policy would have at a time where our economy is timidly showing signs of improvement.

If it is Congress's goal to reduce poverty and give aid to the working poor, a minimum wage increase will only act to stunt economic growth. There are a multitude of ways to help people without harming the vast majority. Stimulating programs through welfare, the Earned Income Tax Credit, S-Chip, Medicaid, the list goes on and on. These are all programs that help America's working poor without causing massive inflation, lay-offs and business closures.

Small business owners are already dealing with serious problems: escalating health care costs, competition from overseas, burdensome regulations, I could go on and on. I ask you not to create another one for us.

Small Business SURVIVAL Committee

Prepared Statement of Michael J. Fredrich

President & Owner
Manitowoc Custom Molding, LLC

On

Would an Increase in the Federal Minimum Wage Help or Hinder Small Business?

Before the

U.S. House Committee on Small Business
Subcommittee on Workforce, Empowerment, and Government Programs
The Honorable W. Todd Akin
Chairman

April 29, 2004

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Chairman Akin and Members of the Subcommittee, thank you for inviting me to be a part of this hearing this morning to discuss the issue of increasing the federal minimum wage and its impact on small business.

My name is Michael J. Fredrich and I am president and owner of Manitowoc Custom Molding, LLC, a firm engaged in the custom molding of thermoset plastic parts. The business is located in Manitowoc, Wisconsin and we have a workforce of 90 full-time employees. Hourly compensation ranges between $8.00-$23.00 per hour.

Business Physics—for every action there is a reaction

An increase in the Federal Minimum Wage will cause actions to be taken within our capitalistic system. The options available to an employee currently making the minimum wage are limited. The employee's choice is to find a job that pays or become a non-employee. The employer has more options. They are as follows:

1. **Raise prices to compensate for the increased labor cost.**
2. **Replace the minimum wage employee with a higher paid, more productive employee.**
3. **Eliminate the job or eliminate a different employee to offset the increased cost.**
4. **Outsource the job.**
5. **Automate the work.**
6. **Accept lower profits.**

The majority of jobs in our country are created by small businesses. Although most small businesses pay wages in excess of the federally mandated minimum wage, the establishment of a higher minimum wage will affect all.

The starting wage at our company is $8.00 plus benefits. The primary benefit is health insurance. The entry positions require very little skill. Increasing the minimum wage will place inflationary pressure on our entry-level wages. If our labor costs are arbitrarily increased, we will be forced to make some tough decisions. One option would be to change our co-pay on our health insurance premiums. We currently pay 80% of the premium and the employees pay 20%. The last two years our premiums have increased over 12% each year. We have fought to keep the 80/20 ratio. A mandated increase in our labor cost will leave us no choice but to increase the employee's participation to 30% to 40%.

A more draconian option would be to outsource the molding of some of our more price-sensitive parts to China. Several of our larger customers serve the retail house wares market and price (down to the penny) is critical. We have established relationships in China for contract molding in situations where we cannot be competitive on price. If we do not facilitate the sourcing of parts, our customers will do it on their own and we will lose all of the business. We will not allow this to happen.

Decisions like those described above are made every day throughout all segments of our economy. Our situation is not unique. Other small companies will react differently but know this—they will react.

Employment vs. Wages

With all the discussion on the need for job creation I am incredulous over the push to increase the minimum wage. It violates a fundamental economic tenet, to wit, if

you increase the price of something (labor), the demand (available jobs) will decrease.

We are going to hire one high school student for the summer to work in our maintenance department. The young man has great mechanical aptitude, however, he has no experience. We will pay him the minimum wage even though he may not be worth $5.15 per hour. As he gains experience his value to the company will increase — both he and the company will benefit. We get several projects completed, and he learns how to work and be productive. Next year, he will be worth more than $5.15 per hour. This year he is not. This job would not exist if we were mandated to pay the young man a higher wage. We would either not fill the position or we would hire someone at a higher wage whose experience is commensurate with the compensation. The young man may eventually find a summer job somewhere else, but one thing is clear — he will not work in our maintenance department doing a job that he prefers.

The opportunity described above can be extrapolated over our entire economy. If job creation is the goal, artificially high wage rates will not advance the cause.

Economists Verify Minimum Wage Problems

The many ill effects of a higher minimum wage have been spelled out in countless economic studies over the years as well. Consider, for example, various reports from the Employment Policies Institute (EPI). In one study, Dr. Kevin Lang of Boston University looked at the displacement factor of wage increases on low-skilled workers by higher skilled workers. Lang noted: "The competition from higher quality workers makes low-skill workers worse off."

• A June 2001 EPI study by economists Richard Vedder and Lowell Gallaway looked at historical data regarding household poverty, and found that "the national minimum wage was ineffective in reducing poverty both in the aggregate and for specific subgroups" based on gender, race, ethnicity and age. In fact, the authors noted that for some groups, "the minimum wage actually appeared to raise the level of poverty." Vedder and Gallaway also examined states with minimum wages above the national level, and found "no statistically significant poverty-reducing effect of the higher state minimum wages."

• An October 2001 EPI report by economists Thomas Mroz of the University of North Carolina at Chapel Hill and Timothy Savage from Welch Consulting Economist noted "that early unemployment delays gains in experience and training that typically lead to higher wages." The economists observed: "Adverse impacts may take the form of lower wages and weakened labor force participation in the future. If these adverse effects are large and persist through time, policies such as raising the minimum wage or increasing unemployment benefits will have sizable but hidden costs."

• In a 1999 research paper for the Federal Reserve Bank of Cleveland, economists David Neumark, Mark Schweitzer and William Wascher reported: "The evidence indicates that workers initially earning near the minimum wage are adversely affected by minimum wage increases, while, not surprisingly, higher-wage workers are little affected. Although wages of low-wage workers increase, their hours and employment decline, and the combined effect of these changes is a decline in earned income."

• Also, consider that a May 1996 Joint Economic Committee Report ("The Case Against a Higher Minimum Wage") pointed out that increasing the minimum wage does not help family sole income earners: "Only 2.8 percent of workers earning less than $5.15 are single parents. Only 1.2 percent of all minimum wage workers were adult heads of households with incomes less than 10,000. Fifty-seven percent of minimum wage workers are single individuals, many of them living with their parents."

What is seen—What is unseen

Wisconsin is considering increasing the minimum wage to $6.80 per hour. The increase is supported by Governor James Doyle. His economic plan states that an increase in the minimum wage will "help workers provide for their families, provide strong incentives to remain in the labor market, and help buoy our local communities that depend on consumer spending." This view is benighted. The Governor ignores what the noted French economist, Fredric Bastiat, described as the "what is seen what is not seen" phenomena. What is seen is that *some people* will clearly benefit from a minimum wage increase. Their hourly compensation will increase from $5.15 per hour to $6.80 per hour. What is not seen is the dark side of government interference.

- **What is not seen is that an increase in the minimum wage will destroy entry-level job opportunities for non-working poor.**
- **What is not seen is the disproportionate effect a minimum wage increase will have on minority teenagers who will lose their jobs in much greater numbers (proportionately) than other demographic segments.**

- **What is not seen is that employers will respond to a mandated increase in their labor costs in a number of ways — all harmful to employees.**
- **What is not seen is the inflationary effect of mandated cost increases on prices of all goods and services in our economy — which disproportionately effect those on the lower end of the economic scale.**

The federally mandated minimum wage is an intrusion on the basic freedom of a person to sell his labor at a price of his choosing. Increasing the minimum wage will only make a bad idea worse.

Thank you again for your leadership Chairman Akin, and for providing me with the opportunity to testify today. I look forward to your questions on this important subject.

Michael J. Fredrich
Bio

Michael J. Fredrich is President and Owner of Manitowoc Custom Molding, LLC, a firm engaged in the custom molding of thermoset plastic parts. Manitowoc Custom Molding is located in Manitowoc, Wisconsin and has 90 full-time employees.

In accordance with Rule XI clause 2(g)(4) of the Rules of the House, neither Manitowoc Custom Molding LLC, nor Michael J. Fredrich has received any federal grant, contract or subcontract from the federal government in the current or preceding two years.

Testimony of

Jared Bernstein, Ph.D.

Senior Economist, Economic Policy Institute

Before Subcommittee on Workforce, Empowerment, and Government Programs

Hearing: "Minimum Wage and Its Effects on Small Business"

April 29, 2004

I sincerely thank the members of the committee for the opportunity to testify on this issue of great importance to working families.

As members of this panel are well aware, the federal minimum wage was introduced in the Fair Labor Standards Act of 1938. At that time, and many times since, Congress has recognized the need for a policy that prevents market forces from driving the wage of our lowest paid workers below a level deemed to be minimal by Congress, and by our general sense of fairness and decency. Since it is not indexed to inflation, the buying power of the minimum wage declines unless our nation's leaders enact an increase. Thankfully, numerous proposals to raise the minimum are currently under consideration and I speak to these specific proposals below.

It is not widely recognized that we as a nation are on track to tie the longest period over which Congress has failed to enact an increase in the minimum wage. As shown in **Figure 1**, the minimum was ignored for nine years over the 1980s, until President George H. Bush signed an increase in 1990. The next increase came under President Clinton in 1996, with bi-partisan support from a Republican-majority Congress. Thus, while increasing the minimum wage is often a divisive issue, it is instructive to note that partisans have historically worked together to ensure that the lowest paid among us are not wholly subject to the vicissitudes of the marketplace. As the figure shows, the current period is the second longest on record without an increase.

The rest of my statement will be devoted to an explanation as to why an increase in the minimum wage is needed with an emphasis on empirical research of the impact of past increases. I will also emphasize the experience of small businesses with respect to minimum wage increases.

The Decline in the Real and Relative Values of the Minimum Wage

Figure 2: Federal Minimum Wage, 1947-2004, Adjusted for Inflation

- The real minimum wage is 30% below its peak level in 1968, and 14% below its 1997 level, when it was last increased.
- The inflation that has occurred since the last increase (passed in 1996) has now fully eroded the value of that increase. In 2004 dollars, the 1995 minimum wage was \$5.19 compared to \$5.15 today.[1]

Figure 3: Federal Minimum Wage Relative to Average Wage, 1947-2004

- In 2004, the minimum wage relative to the average wage was 33%, the lowest value since 1949.[2]

This figure gives an indication as to how far the minimum wage has drifted below the average earnings of production workers in manufacturing and non-supervisors in services. The decline suggests a growing distance between average and low-wage workers and is thus one reason for the growth of economic inequality over the past few decades.

The Share of Workers Affected by Various Proposals

As noted, both Senate Democrats and Republicans have introduced proposals to increase the minimum wage. **Figure 4** shows our estimates of the number and share of workers affected by the actual 1996-97 increase, from \$4.25 to \$5.15, along with projected estimates of two different proposals (both assume an April 2006 phase-in). The bars

[1] In order to put past values in 2004 dollars, I use the most recent (April 10, 2004) Blue Chip forecast of inflation for 2004: 1.9%.

[2] The average wage is the Bureau of Labor Statistics series for production, non-supervisory workers. The 2004 value comes from aging the annual 2003 level by the growth rate of the average wage between the 2003q1 and 2004q1.

represent the number and share of workers earnings between the old and new minimum wage. This value is possibly the single most important variable when evaluating the benefits of a minimum wage proposal to low-wage workers as well as the potential costs to employers.

The last minimum wage increase in 1996-1997 increased the earnings of 9.9 million workers, or 8.9% of the workforce. By this metric, the current proposals are significantly more modest. The larger increase, to $7, proposed by Senate Democrats, would raise the wages of 7.4 million workers, or 5.9% of the workforce, whereas the Senate Republican offer—$6.25—would reach 4.1 million workers, or 3.3% of the workforce. In all cases, the demographic groups who disproportionately benefit from these increases are adults, women, and minorities.

Employment Outcomes: Does the Minimum Wage Hurt Small Businesses?

Despite the fact that contemporary economic research casts a long shadow of doubt on the contention that moderate minimum wage increases cause job losses, opponents still lead with this argument. This so-called "disemployment" argument is particularly difficult to maintain given two relatively recent developments in the history of minimum wages. First, the quality of empirical minimum wage research rose steeply over the last decade, due largely to economists' ability to conduct psuedo-experiments.[3] Such experiments, rare in empirical economics, typically utilize the fact that numerous states (12 as of today) have raised their minimum wage above that of the federal level. Such variation gives researchers a chance to isolate the impact of the wage change and test its impact on employment and other relevant outcomes. As stressed in the Card and Krueger book cited above, these studies reveal employment elasticities that hover about zero, i.e., they solidly reject the conventional hypothesis that any increase in the minimum wage leads to job losses among affected workers.

[3] See, for example, David Card and Alan Krueger. 1995. *Myth and Measurement: The New Economics of the Minimum Wage*. Princeton, N.J.: Princeton University Press.

Second, following the most recent increase legislated in 1996, the low-wage labor market performed better than it had in decades. The fact that the employment and earnings opportunities of low-wage workers grew so quickly following that increase continues to pose a daunting challenge to those who still maintain that minimum wage increases hurt their intended beneficiaries.

Recently, the Fiscal Policy Institute (FPI) released a study of the impact of higher minimum wages on small businesses.[4] Their analysis focuses on various outcomes for businesses with less than 50 employees, comparing these outcomes between states with minimum wages above the Federal level and those at the Federal level. If the theory that higher minimum wages hurt small businesses is correct, then we would expect there to be less growth in such enterprises in states with higher minimum wages. In fact, as shown in **Figure 5**, the opposite is the case.

- Between 1998 and 2001, the number of small business establishments grew twice as quickly in states with higher minimum wages (3.1% vs. 1.6%).
- Employment grew 1.5% more quickly in high minimum wage states.
- Annual and average payroll growth was also faster in higher minimum wage states.

FPI presents similar results for small businesses in the retail sector.

In related research, Waltman et al (1998) examine the relationship between business failures and minimum wage increases.[5] Here again, claims by business-community opponents of the minimum wage suggest that business failures should increase along with minimum wage increases. But in examining this relationship over more than 30 years, Waltman et al conclude that:

[4] *"State Minimum Wages and Employment in Small Businesses,"* Fiscal Policy Institute, April 20, 2004. www.fiscalpolicy.org.

[5] See Jerold Waltman, Allan McBride, and Nicole Camhout, "Minimum Wage Increases and the Business Failure Rate," *Journal of Economic Issues*, Vol. XXXII, No.1, March 1998.

"...there seems to be no discernible correlation between minimum wage increases and a rise in business failures, either in the year the increase occurred or in the following year. If anything, the evidence leans the other way" (pg 221).

The MINIMUM WAGE and Family Income

Opponents of minimum wage increases often criticize its "target efficiency." Since receipt of the minimum wage is not tied to income, critics argue, some of the beneficiaries of the increase are likely to reside in high-income families, and thus don't really need the extra income. In fact, as shown in **Figure 6**, the gains from a minimum wage increase flow largely to those in the bottom third of the income scale.[6]

The figure shows the share of gains from a simulated $1.00 increase in the minimum wage in the year 2000, by income decile. It also shows the distribution of income by decile, allowing a comparison between the distribution of the wage increase to the distribution of income. The distribution of both variables is highly skewed in opposite directions. Family income, as is well-known, is concentrated at the top. The top 10% of families, for example, with an average income of $181,000 in 2000, held 25% of income that year. Their share of the minimum wage increase was 3.4%.

Conversely, at the low end of the income scale, families in the bottom decile—average income, $11,700, received 28.7% of the gains from a minimum wage increase and 2.8% of income. Summing the bottom three quintiles, we see that over half—53%—of the gains from the increase flow to families in the bottom 30% of the income scale, compared to an income share of 14%. The distribution of the minimum wage increase is clearly progressive, especially compared to that of income.

Nevertheless, the figure does reveal that since the minimum wage is not tied to income, some of the benefits from the increase flow to wealthy families. This by no means

[6] The source for the figure is author's analysis of March Current Population Survey data. Non-working families are excluded, and minimum wage gains, which are based on hourly wages reported in March of the survey year, are summed across families.

invalidates the policy, which is intended to set a minimum wage floor for all workers, regardless of family background. However, this result has led some who oppose the minimum wage to argue the Earned Income Tax Credit, the receipt of which is directly linked to family income, is a better policy for low-wage workers.

While the EITC is surely a very important income source for low-wage workers in low-income families, there are a number of reasons to discount the notion that its existence obviates the need for an increase in the minimum wage.

- The policy under discussion is an *increase* in the minimum wage. Simply citing the existence of the EITC has little relevance if the goal is an increase in the incomes of low-wage workers. To be logically consistent, those who cite the EITC as a reason not to raise the minimum wage must advocate for an increase in the tax credit.
- Increasing the EITC has fiscal budgetary costs that must be considered when invoking this policy. The minimum wage does not carry such costs.
- As shown in the next figure, the two—EITC and minimum wages—are complements, not substitutes.

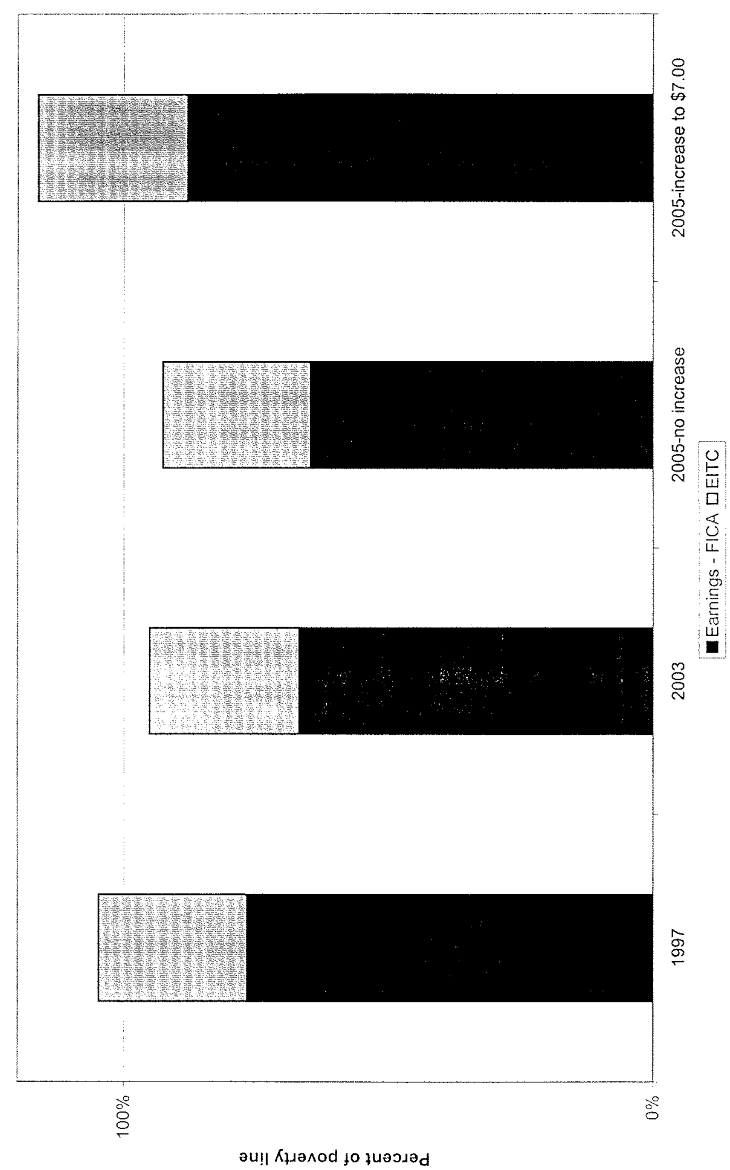
Figure 7 is a simulation of the interaction of the minimum wage, FICA taxes, and the EITC for a full-time working parent with two children. In 1997, after the last minimum wage increase, full-time work at the minimum, along with the EITC, put this family above the poverty line (~$14,800 in 2003). The inflation-induced erosion of the minimum wage by 2003 has meant that even with the EITC (the tax credit is indexed), this single parent is once again below the poverty line, and he/she of course falls further behind by 2005. However, were the minimum wage increased to $7 by 2005, the family would be back above the poverty line. Such analysis reveals the complementary nature of the two policies.

Conclusion

Since the late 1930s, the Federal government has recognized the need for a national wage floor: a minimum wage level below which Congress will not allow wage offers to fall. Unless Congress acts, however, the value of this wage floor will fall behind both inflation and the general upward trend in living standards. In fact, as shown in Figure 1, we are in the midst of the second longest stretch in which Congress and the administration have failed to enact an increase in the minimum wage.

Two proposals are under debate, and I show above that both would cover fewer workers than the last increase enacted in 1996. In this regard, it is notable that following that last increase, low-wage workers faced an all-too-unique period of fast growing employment and earnings opportunities. Evidence presented above, along with much empirical labor economic analysis of this issue, reveal that such moderate increases as those currently under consideration in the Senate have no measurable negative impacts on jobs. In addition, the gains from the increase will largely accrue to those in the bottom third of the income scale. With these empirical facts on the record, Congress should act quickly to raise the wage floor in support of our lowest paid workers.

Figure 7: Minimum Wage, EITC, and Poverty for a Family of Three



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