Effects of Minimum Wage Increases on Income Distribution

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Abstract

Although a majority of the research conducted until now on the minimum wage has been concerned with its effect on employment levels, the main policy goal of having a minimum wage in the first place is to redistribute earnings from high-wage to low-wage workers. This paper focuses on the effects a minimum wage increase can have on income distribution by examining under what conditions such an increase can accomplish the goal of redistributing income to low-paid workers. The issue of who pays for and who benefits from such a redistribution of income is also examined, as well as the positive and negative side effects an income redistribution has on the economy as a whole.

最低賃金に関するこれまでの研究は、その殆どが最低賃金が雇用に与える影響について考察したものである。しかしながら、最低賃金の主要な政策目標は、まず第一に、高賃金労働者から低賃金労働者への所得の再分配である。本論では、最低賃金の引き上げが所得の分配に与える影響に焦点を当てる。最低賃金の引き上げによって、目標とする低賃金労働者への所得の再分配を達成するにはどのような条件が必要なのかを検証したい。所得の再分配が経済全体に与えるプラスとマイナスの副作用や、それを誰が負担し、誰が受益者になるのかについても併せて考察する。

Keyword

minimum wage, income distribution, employment, economy, the poor

最低賃金，所得分配，雇用，経済，貧困層
Introduction

Whenever there is a discussion on raising the minimum wage in the United States, most people tend to focus on its possible effect on the overall level of unemployment. Golan, Perloff and Wu (2001) found that “most of the enormous body of research on the minimum wage as well as the majority of public debates have focused on its unintended employment effects and its effects on wages rather than as its role in redistributing income”. Opponents claim that raising the federal minimum wage will result in the loss of hundreds of thousands of jobs throughout the country, whereas proponents assert that any possible job losses would be minor because employers would be able to manage the impact of increased labor costs by increasing employee efficiency and/or passing on the cost to consumers through higher prices. Although potential unemployment figures are important to consider in any policy debate on the minimum wage, one must realize that the main goal of a minimum wage is not to reduce employment but rather to redistribute earnings from high to low-wage workers.

This paper focuses on the effects a minimum wage increase can have on income distribution and in turn what effects such a redistribution in income can have on the U.S. economy as a whole. First, a brief history of the minimum wage and its value in real terms since its inception will be given as one possible explanation for the recent efforts made by lobbyists to increase the minimum wage at both the state and federal levels. It will then be examined under what conditions a minimum wage increase can effectively accomplish its main goal of redistributing income to low-paid workers. Two other important questions will also be considered. Firstly, who pays for and who benefits from a redistribution of income? Secondly, what are the potential positive and negative side effects of an income redistribution to the economy as a whole? Following this analysis will be a summary of the author’s findings as well as recommendations for possible future research that could give further insights on the issues discussed in this paper.

Background on U.S. Federal Minimum Wage

All U.S. federal minimum wage provisions are contained in the Fair Labor Standards Act (FLSA). Graph 1 summarizes the history of U.S. federal minimum wage increases since the FLSA was first enacted in June 1938. For two decades after the end of World War II, the U.S. federal real minimum wage (defined as the nominal minimum wage divided by the price index) as shown by the light blue line in Graph 1 either rose or kept at a steady level. During the period between 1981 and April 1990 the minimum wage was
fixed in nominal terms at $3.35 per hour. Due to rising inflation, the real value of the minimum wage declined by an astonishing 44 percent during this period. Although this drastic decrease in the real minimum wage during the 1980s can account for a large amount of the economic hardship experienced by young people and workers with low educational levels, Horrigan and Mincy (1993) find that it had only a very modest effect on earnings inequality (Danziger and Gottschalk, 1995).

Graph 1: History of U.S. federal minimum wage increases

The federal minimum wage was then raised a total of four time during the 1990s (from $3.35 to $5.15), followed by three more raises in the 2000s (from $5.15 to $7.25). As of 2015, the federal minimum wage still stands at $7.25 and has not been raised since its last increase in 2009.

When adjusted for inflation, the federal real minimum wage reached a peak of over $10 an hour in 1968. That year, the minimum wage was at its all-time high of 90 percent of federal poverty level guidelines. In addition, since 1959, when guidelines were first established, the minimum wage has averaged about two-thirds of the poverty level. A low point was reached in 2006, just before Congress raised it for the first time in a decade. This also marks the longest period during which the minimum wage remained unadjusted. In 2007, Congress gave individual states the power to set their minimum wages above the federal level (Glass, 2011).
The consistent pressure put on the federal government for tax cuts, especially in recent decades, can be interpreted as one of the many ways discouraged employees have been trying to gain real wage increases that have previously been largely unavailable to them through the labor market. The consensus favoring redistribution of income through the EITC (Earned Income Tax Credit) has been disappearing in recent years due to continual concerns over the federal budget deficit. As could be expected, recent welfare packages passed by Congress have included cuts in the EITC. A lower real minimum wage and cuts in job and other welfare benefits have continually led a greater number of people to support an increase in the minimum wage in the past few decades.

**How Minimum Wage Increases Redistribute Income to Low-Paid Workers**

An increase in the minimum wage is a form of redistribution from higher-income persons (business owners or "capital") to lower income persons (workers or "labor") and therefore should therefore theoretically reduce income inequality. The U.S. Congressional Budget Office (CBO) stated in a February 2014 report that raising the minimum wage either to $9.00 or $10.10, both figures that have been proposed by the U.S. government, would improve income inequality. Families with income more than six times the poverty threshold would see their incomes fall (due in part to their business profits declining with higher employee costs), while families with incomes below that threshold would rise (U.S. CBO, 2014).

According to the FLSA, the main purpose of a minimum wage is to put an income floor under low-wage workers. Since this often involves a redistribution of income from high to low income workers, it is important to consider under what conditions a minimum wage increase can accomplish this. For instance, if the labor market is such that higher-paid workers restore the wage differentials that the minimum wage has attempted to reduce, the redistributive purpose of the minimum wage would be subverted. In this case, some argue that the minimum wage “would have little or no effect on the relative pay of low-wage workers. Rather, it would have a general wage-inflationary effect that might trigger loss of national competitiveness, devaluation of the currency, etc.” (Freeman, 1996). However, because the minimum wage affects such a small proportion of the work force, it seems inconceivable that an increase in the minimum wage would induce wage inflation.

The income distribution and efficiency effects of a minimum wage depend mainly on the social welfare system in which it is embedded. For example, because a typical increase in the minimum wage generates only a 10 to 15 percent wage increase for fewer than 10
percent of the lowest-paid workers in the economy, the distributional effects of such a policy are necessarily limited (Card and Krueger, 1997). In their study of the federal minimum wage increases of 1990 and 1991, Card and Krueger found that the connection between poverty and the minimum wage is weak because most people who live in poverty are non-workers. Through their empirical studies, Card and Krueger also found that contrary to traditional analysis, increases in the federal minimum wage had a positive narrowing effect on the distribution of wages and family earnings. For example, the joint contribution of a minimum wage increase along with increased in-work benefits (such as a pension plan, increased number of vacation days, and longer breaks) might be able to redistribute income much more effectively than solely an increase in the minimum wage.

Redistribution of Income: Winners and Losers

It is also important to consider who benefits from and who must pay for a redistribution of income resulting from an increase in the minimum wage. For instance, if such an increase causes the wages of primarily secondary earners of middle- or upper-class families to rise, then the income distribution case for a minimum wage is obviously weaker than if the beneficiaries are from low-income families.

Generally, beneficiaries of the minimum wage are not among the very lowest income families because those families consist mainly of non-employed workers. Rather, the beneficiaries are often low-wage workers who are often employed in part-time positions. Although in the past the minimum wage largely affected teenagers and young adults, as the earnings distribution has widened in the United States over the past few decades an increasing number of adults have become minimum wage earners. By 1992, a total of approximately 48 percent (comprised of 15 percent of males and 33 percent of females) of workers who were paid the minimum wage were 25 years of age and over (Freeman, 1996). For the years 2011 and 2012, this figure slightly edged up to 50.5% of the total working population (Sherk, 2013).

However, although proposals to increase the minimum wage are often politically popular because they are viewed as a way of helping the poor, most of those earning the minimum wage are not living in poor families. “Since 1995, eight studies have examined the income and poverty effects of minimum wage increases, and all but one have found that past minimum wage hikes had no effect on poverty” (Burkhauser and Sabia, 2010).

As one concrete example of this, during the wave of federal minimum wage increases from $5.15 to $7.25 that occurred between 2007 and 2009, only 15.8% of the workers who
were expected to gain from it lived in poor households (Burkhauser and Sabia, 2010). When
President Obama first ran for president in 2008, he called for the federal minimum wage
to be raised to $9.50 an hour by 2011. Those against his proposal claimed that even if there
were no negative employment or other effects, minimum wage increases don’t reduce
poverty levels substantially because only 11.3% of the workers who would gain from such
an increase live in poor households (Burkhauser and Sabia, 2010). His proposal was soon
cast aside due to the rocky U.S. economy of the post Lehman-shock era. In his more recent
2013 State of the Union address, President Obama called for raising the federal minimum
wage to $9.00 per hour, and promised to make it a priority during his second term.
Regardless, as of the end of 2015, there has been no change in the federal minimum wage
since 2009 and the debate over the minimum wage still rages on in the U.S. Congress.

Although it is clear who will benefit from an increase in the minimum wage (i.e., those
at or very near the current minimum wage at the time), it is somewhat more difficult to
determine who must pay for a redistribution of income caused by a minimum wage
increase. Most economists agree that businesses will make changes to adapt to the higher
labor costs after a minimum wage increase. Thus a decision to increase the minimum
wage is not cost-free; someone has to pay for it (Wilson, 2012). Two potential payers are
the consumers of the products of minimum wage employees and low-wage workers
themselves through possible job loss.

The first group, namely consumers, will likely pay a higher price for those goods and
services produced by minimum wage workers proportional to their share of the cost of
production. Whether this burden falls more on the wealthy or the poor depends on which
income group buys more of the types of goods produced by such minimum wage workers.
For example, many minimum wage workers produce low-priced goods which may be
bought disproportionately by the poor. However, they also work in the private sector in
places that are disproportionately used by higher-income people (e.g., restaurants and
hotels). Therefore without further studies being done, it can be assumed that the incidence
of the minimum wage will most likely be distributed somewhat evenly amongst all income
classes because no single income class in particular is the sole consumer of goods and
services produced by minimum wage workers. Incidentally, during the debate over raising
the federal minimum wage in 1989, an ABC/Washington Post poll asked the general public
whether they would still favor raising the minimum wage even if businesses passed the
increase in salary costs along to the consumer in the form of higher prices on some goods
and services. Amazingly enough, 82 percent of the public answered “yes” to this question
Another group of people that might have to pay the incidence of a minimum wage increase are low-wage workers themselves. If the elasticity of demand for minimum wage workers was greater than one, the minimum wage would reduce rather than increase the share of earnings going to low-paid workers. However, previous studies done on the elasticity of demand for minimum wage workers have consistently shown it to be either zero (Card and Krueger, 1997; Addison, Blackburn & Cotti, 2008; Dube, Lester, & Reich, 2008) or actually a somewhat negative figure in the range of a consensus estimate of -0.3 to -0.1 (Neumark & Wascher, 2007). In addition, there has not been a single study done yet in the United States that has found conclusive evidence that increases in the minimum wage will reduce total employment (Freeman, 1996). In fact, Bryan, Salvatori & Taylor (2012) found that their “findings about the general lack of an employment impact before the recession are consistent with previous studies; and our evidence suggest that [minimum wage increases] had no employment effects during the recession either.” Rather, they found that increases in the federal minimum wage only had a noticeable negative impact on hours worked (approximately 3-4 hours a week), especially among youths.

An absence of noticeable employment losses in these previous case studies does not imply that increases in the minimum wage will not risk large job losses or cause severe levels of unemployment in certain sectors of the economy. However, it does imply that at an aggregate level, little of the cost of an increase in the minimum wage will be borne by low-wage workers. Minimum wage increases may actually likely reduce the probability of becoming employed rather than the probability of remaining employed (Zavodny, 2000).

To summarize, consumers end up paying for the majority of the minimum wage increase (through higher prices, etc.) while low-wage workers themselves pay relatively little of the minimum wage increase through possible small reductions in employment.

**Positive and Negative Side Effects of Redistribution of Income**

Now we will turn our attention to the important positive and negative side effects that a redistribution of income can have on the economy as a whole. Traditionally, microeconomic theory has dictated that low wages are a result of the poor character or low skills of specific individuals rather than a result of slow economic growth or a low level of economic power. However, at the macroeconomic level, we must take into account that one person’s spending is another person’s income. So when an increase in the minimum wage leads to a redistribution of income to the low-wage working class, this also transfers
purchasing power from higher to lower income groups (Prasch, 1996).

It is an accepted fact that the working poor tend to spend a higher percentage of their disposable income versus those in higher income-earning classes, especially on domestically produced goods. Since low-income families have a higher marginal propensity to consume (MPC), an increase in their disposable income will cause an increase in the total quantity of spending and a subsequent increase in aggregate demand. A rise in aggregate demand will theoretically lead to economic prosperity and the creation of more jobs (and thus a reduction in the unemployment rate).

Proponents of a minimum wage increase often point out that although detractors state that only a small share of workers is actually paid the minimum wage, many of those who would be impacted by a raise in the minimum wage are actually low-wage workers making slightly above the minimum wage. In their economic analysis on the minimum wage using data from the U.S. Bureau of Labor Statistics, The Hamilton Project (part of the Brookings Institution) found that 29.4% of the U.S. workforce is paid a wage that is below or equal to 150% of the minimum wage in their state. Thus a minimum wage increase could potentially raise wages for an estimated 35 million workers, based on a workforce size of approximately 122 million non-self-employed workers as of 2012 (Harris & Kearney, 2014).

However, a minimum wage increase can also have a few potential negative side effects on the economy as a whole. First of all, concerns have been raised that an increase in the minimum wage will lead to an increase in the price index level. So even if income is redistributed to low-wage workers, increases in the price index might be so high as to offset any increases in income that result from a higher minimum wage rate. Unemployed workers with no income whatsoever would be hurt by this situation the most since they would find it even harder to survive in an increasingly expensive world. Also, even subtle increases in the price level would hurt bondholders, who would find the value of their bonds decreasing in real terms. However, this extreme scenario would only occur if all goods in the economy were made by minimum wage workers and there were no other costs to production. Therefore this does not seem to be a substantial argument.

Another possible negative side effect of an increase in the minimum wage is that workers who are beneficiaries of means-tested in-work benefits might see their benefits fall and the amount of income tax that they must pay rise. A minimum wage that is limited to hourly pay could lead some employers to reduce other benefits, possibly in ways that would make their workers worse off overall. For example, in order to cut costs, an
employer might eliminate pension plans or other favorable working conditions. Thus “a minimum wage that simply reallocated the costs of labor from indirect benefits to hourly wages would have no effect on employment, but would arguably reduce the well-being of the affected workers” (Prasch, 1996). The incomes of such workers would still be greater than before the minimum wage increase unless their working hours were cut by a large amount.

Other examples of possible negative side effects that have been cited by critics of a minimum wage increase are: employers might cut job training or other fringe benefits, increased job turnover, increased inflationary pressure, the hiring of illegal aliens, and increased likelihood and duration of unemployment for low-wage workers, particular during economic downturns (Wilson, 2012).

Conclusions

The purpose of this paper has been to show the effects a minimum wage increase can have on redistributing income, rather than solely considering its effect on the level of unemployment as many academic research papers have tended to do. It was shown that a minimum wage increase, through its positive effect on redistributing income from higher to lower classes, can improve the well-being of many low-wage workers while also working to limit the rising tide of earnings inequality that has inundated the United States during the past several decades. And although the analysis of Card and Krueger (1997) regarding the federal minimum wage increases of 1990 and 1991 showed that the connection between poverty and the minimum wage to be weak because most people who live in poverty are not in the work force, through their empirical studies they also found that contrary to traditional analysis, increases in the federal minimum wage had a positive, narrowing effect on the distribution of wages and family earnings.

In the future, it would be worthwhile to do a study on which income groups are the main consumers of goods produced by minimum wage workers. The results of this type of study would be useful when discussing who pays the incidence of a minimum wage increase. The study would make it clearer which income classes would be affected most by a minimum wage increase because currently it is somewhat unclear as to which income group consumes a majority of the goods and services produced by minimum wage workers.

At best, a minimum wage increase will shift the earnings distribution in favor of low-paid workers while also keeping those in the lowest-earning deciles from experiencing
further increases in earnings inequality. At worst, it will reduce the share of earnings going to low-paid workers through job displacement. Although not conclusive, the majority of academic literature written on the effects of minimum wage increases tends to conclude that the risks likely outweigh any positive effects from income redistribution. It is the uncertainty of such potential risks versus gains that makes a minimum wage increase proposal so controversial.

In addition, due to continuing recessionary conditions in the U.S. that started with the Lehman Shock of 2008, many would assert that the problem plaguing America’s poor is not necessarily low wages, but rather a shortage of jobs. According to the Bureau of Labor Statistics, the most recent U.S. labor force participation rate (62.4% as of October 2014) was at its lowest since 1977. Under such conditions, government policymakers would be wise to avoid policies that destroy precious job opportunities. With this point in mind, it has become all the more important for future studies on the minimum wage to try to clarify the effect it has on employment levels.

An increase in the minimum wage also brings with it the risk of efficiency loss because many workers would be paid higher wages for the same amount of productivity. Furthermore, evidence has shown that increases in the minimum wage may not always help those it is truly intended for (i.e. the poor). Due to ever-present inflationary pressures in the U.S. economy that cause the real value of the minimum wage to decline on a yearly basis, the debate surrounding the federal minimum wage tends to be more about the timing of when to raise it rather than whether to raise it or not. Consequently, the debate will be a never-ending one for U.S. politicians.

References


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