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## Discussion Paper Series

**Revisiting the Minimum Wage-Employment Debate:  
Throwing Out the Baby with the Bathwater?**

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## Executive Summary

### Revisiting the Minimum Wage-Employment Debate: Throwing Out the Baby with the Bathwater?

Debates about the economic effects and the merits of the minimum wage date back at least as far as the establishment of the Department of Labor as a cabinet-level agency in 1913. In the decades that followed, neoclassical and progressive economists reached different conclusions, but eventually began to coalesce around the idea that minimum wages tended to reduce employment among low-skilled workers. This consensus lasted through the 1980s and ended with the publication of a special issue of the *Industrial and Labor Relations Review* (ILRR) in the early 1990s. This issue featured four studies that took advantage of the increasing divergence of minimum wages at the state level to estimate the employment effects of the minimum wage. The four studies, using different analytical approaches, were diverse in their findings ranging from disemployment effects similar to the earlier consensus, to a positive effect of the minimum wage on employment. The ILRR symposium launched a new body of contemporary research on the minimum wage, much of which was summarized in Neumark's and Wascher's 2008 book, *Minimum Wages*. In that book, their evaluation and summary of the evidence concluded that "...[M]inimum wages reduce employment opportunities for less-skilled workers, especially those who are most directly affected by the minimum wage." This paper, in part, extends this evaluation and summary to the present by evaluating two recent studies that have questioned the empirical methods and conclusions in much of the recent literature.

The criticism of these recent studies can be summarized as follows: past research uses invalid "control groups." In minimum wage studies, a control group is often another state that did not experience an increase in the minimum wage. A well chosen control group must reflect the same policy and economic changes other than the change in minimum wage. Without a good control group a researcher may attribute a reduction in employment to the increase in the minimum wage, when in reality the reduction in employment is caused by something else. These recent studies claim that past research makes use of control groups that are too geographically separated from the states where minimum wage changes occurred. They argue that dozens of state minimum-wage increases that occurred in the United States in recent years happen to have occurred in regions where the employment of low-skilled workers was declining for other reasons. These employment declines were tied to local economic conditions that did not affect the geographically distant control states. This in turn led researchers to attribute the decline in unemployment to the minimum wage increase, when in reality it was the result of a local economic decline. To measure the true effect of minimum wage increases, they argue that one must compare what happened in states where minimum wages increased only to states in the same Census division or to counties on the other side of the state border. When they perform the analysis using these alternative control groups, the negative employment effects associated with a rising minimum wage disappear.

### Analysis & Results

The control groups chosen in these new studies have an intuitive appeal: nearby states or counties could provide better controls for states where minimum wages increased because they might be exposed to similar economic shocks. However, rather than relying on intuition, David Neumark, Ian Salas, and

William Wascher carefully test whether the methods used in these recent studies represent a valid threat to findings from previous research. They reach three main conclusions.

- First, it is typically not nearby states or counties that provide the best control groups – undermining the key assumption imposed by the revisionist studies. Neumark et al. use a statistical method to determine which states are the best controls. This method provides numerical “weights” which can be assigned to each potential control state. Weights range from 0 to 1 and the closer a weight is to 1, the better that state is as a control. They find, on average, that nearby states only receive about 25% of the weight and other states receive nearly 75% of the weight.
- Second, in the isolated cases of states where nearby states and counties are a good control group, the estimated minimum wage effects on employment are again negative. Using the weighting procedure described above, it was determined that in the West North Central region, more than 50% of the control-state weight should go on states in the same region. When the employment effects of the minimum wage are computed for this region alone, the authors find that for each 10% increase in minimum wage, employment for teens declines by 1.9% - an effect that is very much in line with past studies.
- Third, when the analysis is not restricted to nearby states or cross-border counties, the evidence on minimum wages is consistent with earlier studies. Using the same data as is used in these revisionist studies, but now allowing all potential control states to serve as controls, Neumark et al. find that for a 10% increase in the minimum wage, employment for teens is reduced by 1.65% - once again, a result that is similar to those found in previous research.

### **Policy Implications**

The results of this study suggest that policymakers should not be too quick to set aside the tested economic consensus regarding the impact of minimum wages. Empirical evidence continues to suggest that minimum wages pose a tradeoff of higher wages for some against job losses for others.

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## I. Introduction

Debates about the economic effects and the merits of the minimum wage date back at least as far as the establishment of the Department of Labor as a cabinet-level agency in 1913. Given the absence of empirical evidence on the effects of minimum wages in the early 1900s, the initial debates were largely based on theoretical reasoning. The neoclassical school (including John Bates Clark, H. B. Lees-Smith, and Frank Taussig) argued that wage levels were determined by workers' productivity and that minimum wages would reduce employment among low-skilled workers. In contrast, the progressives (such as Sidney Webb, Rogers Seager, and John Commons) argued that minimum wages were necessary to prevent the widespread exploitation of lower-skilled workers by employers with greater bargaining power over wages, would encourage workers to increase their efforts, and would boost consumers' purchasing power and thus raise aggregate demand.

A similar debate erupted after the federal minimum wage was enacted in 1938. The main protagonists at that time were George Stigler (1946) and Fritz Machlup (1946), representing the "marginalist" school of economists, and Richard Lester (1946), who was considered an "institutionalist" economist. Again, the debate was primarily about the appropriate theoretical model of the labor market, although both sides also attempted to bolster their arguments with empirical analyses. Stigler and Machlup took the neoclassical position that minimum wages reduce employment, while Lester argued that product demand rather than wage rates was by far the most important factor determining employment so that fairness was the more appropriate consideration in setting a wage floor.<sup>1</sup>

Economists and statisticians from the Department of Labor have contributed importantly to the empirical literature on the economic effects of minimum wages over the past century. One of the first statistical analyses of minimum wages in a U.S. state was conducted by Marie Obenauer and Bertha von der Nienburg of the Bureau of Labor Statistics (BLS) in 1915, who examined the effects of a minimum wage for women that was introduced in Oregon between October 1913 and February 1914. For this

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<sup>1</sup> Stigler acknowledged the possibility that minimum wages could raise employment in a labor market with a monopsonistic employer, an idea that would become more prominent in the 1990s. However, his own view was that low-wage markets were generally competitive in nature and thus that such monopsony effects were unlikely to be important in U.S. labor markets.