The Minimum Wage and Employment Dynamics
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The minimum wage remains one of the most controversial policies in both the public discourse and labor economics. The recent proposal by President Obama to raise the federal minimum wage has brought this issue to the fore once again. The reaction was predictable: some argued that this would cause serious unemployment problems, while others pointed to opposing research showing that the minimum wage has little, if any, effect on employment. In this brief, we discuss recent research in which we revisit the question of the effects of the minimum wage using a different approach. We directly examine employment dynamics – namely, the rate of net job growth – rather than the total number of jobs. We argue that the minimum wage is more likely to impact employment dynamics for a number of reasons, and estimate the effects on net job growth using data from the U.S. Census Bureau, finding that the minimum wage reduces net job growth, primarily through its effect on job creation by expanding establishments.

The most commonly-cited economics research on the minimum wage is a 1994 paper by David Card and Alan Krueger. The authors surveyed about 400 fast food restaurants in New Jersey and Pennsylvania immediately before and about nine months after New Jersey increased its minimum wage. They compared employment at these restaurants before and after the increase, between the state with and the state without an increase, and found no impact of the minimum wage. There have been numerous papers in the two decades following the publication of Card and Krueger’s work, some of which criticized their methodology and found negative effects of the minimum wage on employment. Others, using increasingly sophisticated econometric techniques and broader data, have also found no effects. It would be safe to characterize the state of the literature on the subject as contentious.

Our findings are unequivocal: higher minimum wages lead to lower rates of job growth.

While nearly every paper in the long literature on minimum wages and employment has focused on the number of people employed, there are several reasons, grounded both in theory and data, to expect the effects to be reflected in the rate of net job growth (see, for example, Sorkin [2013]). Despite the predictions of neoclassical economics, a near-instantaneous adjustment to a new level of employment in response to higher labor costs is unlikely (Hamermesh [1989]). These transitions may be slow due to adjustment costs or even an aversion to firing existing employees, so it is more likely that minimum wage increases result in a change in the rate
at which employment grows.

This phenomenon becomes more clear when one considers the composition of the minimum wage work force. Using the Current Population Survey’s Merged Outgoing Rotation Groups from 1979 to 2011, we found that, although only about 3.3% of all employees are paid the minimum wage, nearly 12% of those who enter the workforce are paid that amount. Indeed, nearly a third of minimum wage workers are recent workforce entrants. Minimum wage workers are also likely to transition to higher pay quickly: of those who remain employed after one year, about 60% are paid in excess of the minimum wage the following year. As such, it seems likely that any effects of the minimum wage are more likely to be reflected among new workers and in new job openings than on the existing stock of employment.

Yet, the previous literature has not focused on dynamics. This is particularly worrisome because, unlike many of the other policies that economists study, the minimum wage is characterized by frequent, relatively small increases. This means that slow adjustments in response to these increases are difficult to detect. Moreover, in Meer and West [2013], we use a simulation to show that a common practice in regression analysis in this literature – including state-specific time trends – leads to incorrect estimation of the effect of the minimum wage on the level of employment when the true effect is on the rate of employment growth. Essentially, the deck is often stacked against finding any effect.

The data for our study are drawn from the Business Dynamics Statistics (BDS), which covers the population of non-agricultural private employer businesses between 1977 and 2011. The underlying data are sourced from mandatory employer tax filings and aggregated by state in each year. The BDS includes not only the number of jobs in each state for every year, but the number of jobs created by expanding establishments and the number of jobs destroyed by contracting establishments. These numbers are used to calculate the rate of net job growth.

We combine the BDS with data on state minimum wages and other state attributes, like the state economic environment, to estimate how
the minimum wage affects the rate of net job growth. We also account for annual shocks to the outcome variables occurring at the regional level, to account for any conditions that lead a state to see both a change in the minimum wage and job growth. This would be a concern if, for instance, a state legislature responded to lower job growth with a minimum wage increase. We also conduct a number of robustness checks to ensure that our results are not driven by spurious correlation. For instance, we show that future increases in the minimum wage do not predict current job growth outcomes. If they did, we would be concerned that other factors are driving the correlation.

Our findings are unequivocal: higher minimum wages lead to lower rates of job growth. Indeed, a ten percent increase in the minimum wage causes roughly half a percent point reduction in the rate of job growth, a very large effect. The effect of this hypothetical increase is not permanent, though, since it is eroded by inflation and increases in the state’s comparison group. Our calculations show that this ten percent increase in a state’s real minimum wage, relative to its regional neighbors, causes a 1.2 percent reduction in total employment relative to what it would have been. We further find that this appears to be driven primarily by reductions in job creation by expanding establishments, not by increases in job destruction by contracting establishments. Essentially, then, the intuition is that employers respond to the minimum wage by growing more slowly.

Judging whether the effect we find is large or small is not necessarily simple. Some might point to a 1.2 percent reduction in the level of employment after five years and argue that is relatively small – it represents about 23,000 fewer jobs for the average state – and that those who earn the minimum wage and remain in the labor force would earn more. But that argument seems coldly indifferent to those who remain outside of the labor market, unable to take advantage of the relatively rapid transitions out of minimum wage jobs. At a broader level, it is important to note that, in contrast to much of the previous literature and the dismissiveness of some advocates, we document that the minimum wage does, in fact, affect employment.

The District of Columbia City Council recently passed an ordinance that would raise the District’s minimum wage to $12.50 per hour, but that would apply only to large retailers. In response, Walmart announced that it would no longer build three of the stores it had planned to open in the city. This sort of response is precisely the type of effect that we found in our study: a reduction of job creation, not a loss of existing jobs. Minimum wage policies may not cause an immediate shock to employment, as is often feared, but a reduction in the rate of net job growth. This effect is all the more insidious for being difficult to detect. Employment growth is slowed, but more importantly, the long-run prospects for individuals are damaged, as they are delayed in the opportunity to develop skills and work experience – to grasp that crucial first rung on the career ladder.

References


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