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FOR IMMEDIATE RELEASE:
Friday, February 3, 1995

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ASSESSING A \$5.15-AN-HOUR MINIMUM WAGE

by Isaac Shapiro

President Clinton's proposal to increase the minimum wage to \$5.15 an hour via two 45 cent increases is a positive step for low-wage workers. In terms of restoring the value of the minimum wage, however, it should be considered a moderate and partial step.

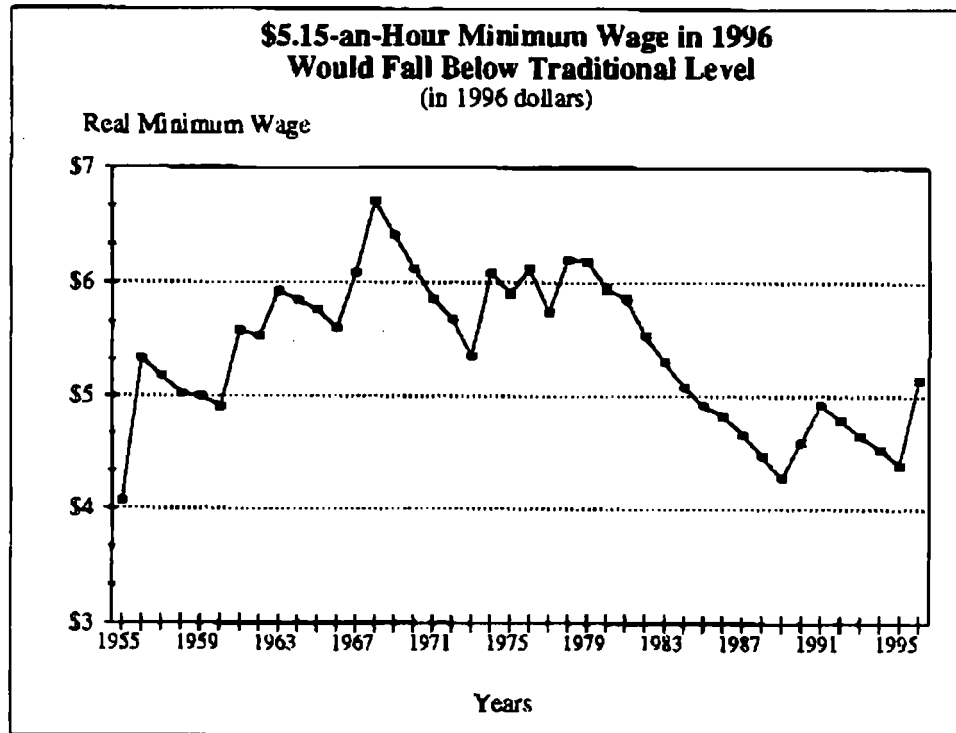
- Raising the minimum wage to \$5.15 an hour in 1996 would make up slightly more than half of the ground that was lost to inflation during the 1980s.
- A minimum wage of \$5.15 an hour in 1996 would be 13 percent below its average purchasing power during the 1970s, after adjusting for inflation.
- If the minimum wage were to have the same purchasing power in 1996 as it averaged during the 1970s it would need to equal \$5.93 an hour.

Recent studies also suggest that the proposal will not undermine employment opportunities. The proposed increase is roughly in the range of increases in the federal and state minimum wages that have been studied in recent years, with the preponderance of the evidence finding that they did *not* cause job losses. These include studies which examined the two-step 90 cent increase in the federal minimum wage at the turn of the decade as well as state increases to levels of nearly \$5.70 an hour in 1996 dollars.

Effect on the Value of the Minimum Wage

The explanation for why the value of the minimum wage would remain well below its traditional level even if it is raised to \$5.15 an hour lies in the history of the minimum wage since 1981.

From January 1981 to April 1990, the minimum wage remained frozen at \$3.35 an hour, despite a 48 percent jump in the cost of living. The minimum wage was then raised in two steps to \$4.25 an hour. But these raises made up only some of the ground



lost to inflation. In 1991, *after* the minimum wage was increased to \$4.25 an hour, its value was 17 percent below its average level in the 1970s.

Since April 1991 the minimum wage has stood still while the cost of living has continued to rise, increasing by 11 percent during this period. Consequently, the purchasing power of the wage standard has deteriorated further.

- The purchasing power of the minimum wage is now 26 percent below its average value in the 1970s, after adjusting for inflation.
- The real value of the minimum wage is now above its value in 1989 but is below its value for every other year going back to 1955. Without action to increase the minimum wage, by 1996 the wage floor will fall to its lowest level in more than four decades.
- Similarly, changes in the minimum wage have not kept pace with changes in the wages of other workers in the economy. In the 1950s and the 1960s, the minimum wage averaged more than half of the average wage of private nonsupervisory workers. In the 1970s, it averaged 46 percent of the average wage. Currently, it equals 38 percent of the average wage.

- Another comparison of interest is that during the 1960s and the 1970s, the earnings of a full-time minimum wage worker employed for the entire year typically were enough to lift a family of three out of poverty even without considering other sources of income. In 1995, full-time minimum wage earnings by itself will fall 27 percent below the estimated poverty line for a family of three.

A minimum wage of \$5.15 an hour in 1996 would be a helpful step towards restoring the strength of the minimum wage. The wage standard, however, would fall well short of the benchmarks described above.

- The minimum wage would remain 13 percent below its traditional level of purchasing power. If the minimum wage were to have the same purchasing power in 1996 as it averaged in the 1970s, it would need to be \$5.93 an hour. A minimum wage of \$5.15 an hour in 1996 would be below its value throughout the period from 1961 to 1983, after adjusting for inflation.
- In 1996, the wage floor would equal 43 percent of the projected average nonsupervisory wage, substantially below the 50 percent benchmark.¹
- Full-time year-round minimum wage earnings alone in 1996 would equal 85 percent of the estimated poverty line for a family of three.²

Moderate Increase Would Have Negligible Employment Effect

Recent experience with federal and state minimum wage reforms suggest that the federal minimum wage could be increased to \$5.15 an hour in 1996 without causing adverse employment effects of a significant nature. This conclusion is based on an examination of important recent studies which used several different methodologies to assess the effects of raises in the federal minimum wage both across the nation and in particular states, as well as the effects of raising state minimum wages above the federal level.

¹ This projection assumes that the average private nonsupervisory wage increases at the same pace as inflation in 1995 and 1996.

² The recent expansion in the federal Earned Income Tax Credit fills this gap for certain minimum-wage families. But for most minimum-wage workers, the combination of a \$5.15-an-hour minimum wage and the new EITC in 1996 will be less than their combined value in 1996. The minimum wage also has several advantages over the EITC — it does not raise marginal tax rates and is received in a timely manner throughout the year. The EITC and the minimum wage are best viewed as complementary policies and not as substitutes for each other.

Among the recent studies which found that the examined minimum wage increases did not cause job loss are:

- Studies of the federal minimum wage which examined the effects of raising the minimum wage in two 45 cent increases from \$3.35 an hour in 1989 to \$4.25 an hour in 1991.³⁴ A minimum wage of \$4.25 an hour in 1991 is equivalent to a minimum wage of \$4.93 an hour in 1996.
- A study that examined the effects of New Jersey raising its state minimum wage by 80 cents, from \$4.25 an hour to \$5.05 an hour in 1992 (\$5.69 in 1996 dollars).⁵
- A study of the effects of California increasing its minimum wage 90 cents from \$3.35 an hour in 1987 to \$4.25 an hour in 1988 (\$5.68 in 1996 dollars).⁶

After reviewing these and other recent studies of federal and state minimum wage changes — including a study which updated what had generally been considered the best study of the employment effects of the minimum wage during the 1960s and the 1970s with information through 1986 and found only a small effect on teenage employment⁷ — the noted Harvard labor economist Richard Freeman concluded:

³ David Card, "Using Regional Variation in Wages to Measure the Effects of the Federal Minimum Wage," *Industrial & Labor Relations Review*, October 1992. The Card study examined only the first 45 cent increase.

⁴ Lawrence Katz and Alan Krueger, "The Effect of the Minimum Wage on the Fast Food Industry," *Industrial & Labor Relations Review*, October 1992.

⁵ David Card and Alan Krueger, "Minimum Wages and Employment: A Case Study of the Fast Food Industry in New Jersey and Pennsylvania," *American Economic Review*, Volume 84, Number 4, September 1994.

⁶ David Card, "Do Minimum Wages Reduce Employment? A Case Study of California, 1987-89," *Industrial and Labor Relations Review*, October 1992.

⁷ Alison J. Wellington, "Effect of the Minimum Wage on the Employment Status of Youths: An Update," *The Journal of Human Resources*, Winter 1991. Wellington found that a 10 percent increase in the minimum wage was associated with a 0.6 percent decrease in teenage employment and that the decrease was not statistically significant. Wellington updated the study conducted by economists for the federal Minimum Wage Study Commission, which found a 10 percent increase in the minimum wage to be associated with a one percent decrease in the employment of teenagers and found no strong evidence of any job loss for adults age 25 and over. Charles Brown, Curtis Gilroy, and Andrew Kohen, "Time-Series Evidence of the Effects of the Minimum Wage on Youth Employment and Unemployment," *The Journal of Human Resources*, Winter 1983. Many of the estimates of large job losses made during the debate over the appropriate size of the minimum wage in the late 1980s were based on the high range of studies from the 1960s and the 1970s, often ignoring the review and update of these studies by Brown, Gilroy, and Kohen.

"That moderate increases in the minimum [wage] transferred income to the lower paid without any apparent adverse effect on employment ... at the turn of the 1990s is no mean achievement for a policy tool in an era when the real earnings of the less skilled fell sharply."⁸

These studies do not suggest or prove that *any* increase in the minimum wage — no matter how large — would have only desirable effects. But the outcomes of the studies suggest that the labor market functions in a more complicated manner than has been assumed by those contending that virtually any rise in the minimum wage results in a significant decrease in employment levels. For example, a higher minimum wage can make it easier for employers to fill vacancies and may decrease employee turnover. Both examples suggest circumstances in which a boost in the minimum wage can boost employment.

The studies *do* suggest that when the minimum wage is at especially low levels, as it is today, the employment effects of a moderate increase in the minimum wage — such as the proposed increase to \$5.15 an hour — are likely to be negligible.

(For a fuller discussion of the relationship between the minimum wage and employment, see the Center on Budget and Policy Priorities report "Four Years and Still Falling: The Decline in the Value of the Minimum Wage," January 11, 1995.)

Note on Inflation-adjustment Methodology Used in this Analysis

This analysis uses the latest projected inflation estimates from the Congressional Budget Office: inflation of 3.1 percent in 1995, and of 3.4 percent in 1996.

In adjusting the value of the minimum wage for inflation, this report used the experimental measure of changes in the cost-of-living, called the "CPI-U-X1". This measure was used instead of the government's official measure, the "CPI-U", because some analysts believe the CPI-U did not accurately adjust for changes in housing costs prior to 1983, thereby overstating inflation. (This analytic issue is separate from recent discussions — sparked in part by recent testimony by Alan Greenspan, chairman of the Federal Reserve Board — that inflation is currently being overstated.)

Although some analysts still believe the CPI-U is the preferable inflation measure to use for certain time-series, this report used the CPI-U-X1 so as to err on the conservative side. That is, if the CPI-U had been used instead of the CPI-U-X1, the erosion in the value of the minimum wage would have been shown to have been even larger. For example, using the CPI-U, if the minimum wage were to have the same value in 1996 as it averaged in the 1970s, it would need to equal \$6.21, compared to the \$5.93 figure mentioned in the full text that was generated by using the CPI-U-X1.

⁸ Richard B. Freeman, "Minimum Wages — Again!" *International Journal of MANPOWER*, Volume 15, Numbers 2/3, 1994.