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Minimum Wage

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bcc: Ms. Amy Zisook ✓
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EXECUTIVE OFFICE OF THE PRESIDENT
COUNCIL OF ECONOMIC ADVISERS
WASHINGTON, D.C. 20500

March 1, 1993

Dear Mr. Gorman:

The meeting we had last Monday was very useful--I hope for you as well. Please thank your colleagues for participating.

I can answer a few questions right away. First, while the details have not yet been drafted, the Administration's proposed investment tax credit will include service businesses; however, the targeted capital gains relief will not. Second, the Labor Department is still considering the minimum wage issue and has not reached any decision. I have passed along your group's views, including the FICA "tips" credit and the difficulty of using the training wage.

Yours very truly,



Alan S. Blinder

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FAX TRANSMITTAL SHEET

file:
minimum
wage



RECEIVER TELECOPIER #: 395-6947

TO: Dr. Alan Blinder

FROM: Larry Katz

DATE: 2/25/93 TIME: 9:15 AM

PAGE NUMBER ONE OF 3 PAGES.

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MEMO

TO: Alan Blinder
FROM: Larry Katz
RE: Some Rhetoric on the Minimum Wage
DATE: February 25, 1993

The Federal minimum wage is currently \$4.25 an hour. The minimum wage was last increased in April 1991 from a level of \$3.80 in 1990. The minimum wage had been frozen at a nominal level of \$3.35 per hour from 1981 to 1990. Despite moderate increases in the minimum in 1990 and 1991, the real minimum wage is lower today than at any time in the 1960s and 1970s. A worker in a full-time, full-year job earning the minimum wage would generate a family income below the poverty level even for a family of two and substantially below the level for larger families. The ratio of the minimum wage to the average wage of nonsupervisory workers (or all workers) is also lower today than at any time in the 1960s and 1970s.

There currently exists a youth subminimum wage (or training wage) for up to 180 days for teenagers. The training wage expires at the end of March 1993. Most research indicates that almost no firms use the training wage option. Employer groups argue that the rules concerning the use of the training wage are unclear and administratively complex. But survey research by Katz and Krueger finds that most employers feel they can't attract workers at the subminimum or do not find the option of differential wages for teenagers and 20 year olds doing the same job to be very attractive.

The minimum wage has two primary purposes. The first is as an anti-poverty program. Although the minimum wage is not a targeted policy (like the earned income tax credit), it still is a somewhat effective anti-poverty policy. Many criticize the minimum wage as an anti-poverty program by arguing that many of the beneficiaries are teenagers and other "secondary earners" from middle class families with multiple earners. This is certainly accurate. Minimum wage workers are spread throughout the family income distribution and only moderately concentrated in the bottom two quintiles. Thus increases in the minimum wage have only trivial effects on the overall family income distribution. Nevertheless, most research shows that increases in the minimum wage substantially increase the incomes of many low-income families and reduce the poverty rate; see recent work by Ron Mincy in the Monthly Labor Review and work by Mincy and Horrigan.

The second justification of the minimum wage is as a part of a minimal set of labor standards designed to prevent firms from competing on the basis of extremely low wages and that to try to spur firms to create and maintain the high-wage, high-performance workplaces. Standard economic theory does not view this justification very favorably.

The main criticism of the minimum wage is that it serves to raise employer costs and reduce employment and training opportunities for teenager and disadvantaged workers. Empirical evidence covering the experience of the 1950s, 1960s, and 1970s indicates moderate adverse effects of the minimum wage on teenage employment (elasticities of around -0.1). Research examining the experience of the 1980s and 1990s finds even smaller adverse employment effects. Similar results of little adverse employment effects have been found using cross-state variation in response to changes in the Federal minimum wage (Card, 1992; Katz, 1992); examining state minimum wage changes (Card for California and Card and Krueger for New Jersey); and comparing response of constrained and unconstrained employers in response to minimum wage increases (Katz and Krueger, 1992); and updated time series research (Wellington, 1991). One recent exception is a study of employment in California retail trade following the California's 1988 state minimum wage increase. This well-designed study by Taylor and Kim does find significant adverse effects in low-wage California counties.

My overall assessment of the evidence is the the employment response to moderate increases in the minimum wage from today's historically low level is likely to be small. The employment elasticity for teenagers is probably in the 0 to -0.1 range and the elasticities for older workers are essentially zero. Some low-wage retail trade industries are likely to respond with somewhat larger employment declines. An immediate large increase in the minimum wage (more than 15 percent) could have significant adverse employment effects especially given the current slow pace of job creation. Moderate increases once employment growth has become more robust will probably not create serious negative consequences.