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Minimum Wage

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MEMORANDUM

COUNCIL OF ECONOMIC ADVISERS

File Minimum Wage

April 1, 1996

MEMORANDUM FOR: JOSEPH STIGLITZ
MARTIN BAILY
ALICIA MUNNELL
TOM KANE
MICHAEL ASH

FROM: PETER ORSZAG

SUBJECT: Draft talking points on the minimum wage

Alicia asked me to put together some talking points on the minimum wage. Comments and corrections are welcome (as are suggestions for providing more detail on specific topics).

The value of the minimum wage

- The President has proposed to increase the minimum wage from its current level of \$4.25 an hour to \$5.15 an hour by July 1997. The increase will occur in two 45-cent steps: to \$4.70 in July 1996, and to \$5.15 in July 1997.
- The minimum wage has not been raised since April 1, 1991. On November 10, 1989, President Bush signed a 90-cent minimum wage raise. This increase, like the proposed one, took place in two 45-cent steps: from \$3.35 to \$3.80 on April 1, 1990, and from \$3.80 to \$4.25 on April 1, 1991.
- If the minimum wage is not increased within a year, it will fall to its lowest real level in 40 years. The attached table shows the value of the minimum wage in nominal dollars, real dollars, and as a percentage of the average private nonsupervisory wage. The Labor Department expects the real value of the minimum wage to fall below \$3.92 (its 1955 level in 1995 dollars) in January 1997.
- The increase would raise a full-time, year-round minimum wage worker's annual income by \$1,800 (90 cents over 2000 hours).

Workers directly affected by the increase

- In 1995, 9.7 million hourly-paid workers earned between \$4.25 and \$5.15 an hour.

-- 59 percent of these workers are women

-- 69 percent are adults

-- According to the Economic Policy Institute, almost two-fifths are the sole wage-earners in their households

- These figures apply to those directly affected only. To the extent that a minimum wage increase shifts the wage distribution even for workers currently earning more than \$5.15 an hour, the impact is broader. Research indicates that the "ripple" effect would affect at least the 3 million additional workers who earn between \$5.15 and \$5.75.

Current minimum wage workers

- The average share of household income earned by a minimum wage worker is one-half.
- In 1995, 2.0 million hourly-paid workers earned precisely \$4.25 an hour; 3.7 million earned \$4.25 or less (workers earning less than \$4.25 an hour are either not covered by the \$4.25 minimum wage or have incorrectly reported their wages or hours).
- The attached charts provide additional information on workers who were earning the minimum wage in 1993.

The employment debate

- There is an ongoing (and vitriolic) debate over the employment effects of an increase in the minimum wage. Roughly a dozen empirical studies published in peer-reviewed journals over the past 5 years find an insignificant effect (see attached list). While these results are not yet unanimously accepted in the academic community, there does seem to be a growing consensus that the employment effects are unlikely to be large. Robert Solow is often quoted as saying that the evidence "on job loss is weak. And the fact that the evidence is weak suggests that the impact on jobs is small."

Inflationary impact

- A WEFA study concluded that the President's proposal would raise the inflation rate during the transition period by less than 0.1 percentage point per year.

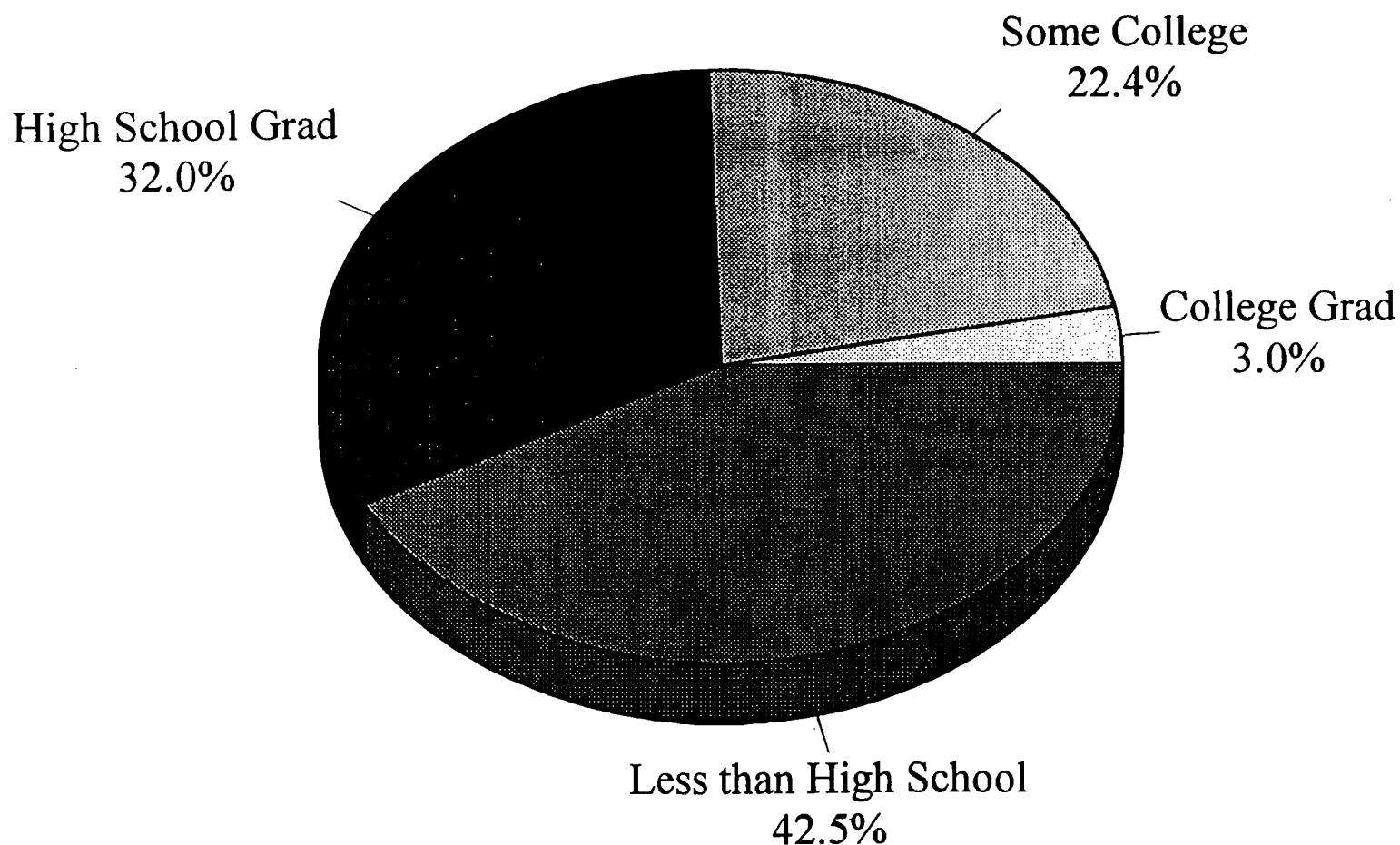
Value of the Minimum Wage, 1955-1995

<u>Year</u>	<u>Value of the Minimum Wage, Nominal Dollars</u>	<u>Value of the Minimum Wage, 1995 Dollars</u>	<u>Minimum Wage as a Percent of the Average Private Nonsupervisory Wage</u>
1955	\$0.75	\$3.92	43.9
1956	1.00	5.14	55.6
1957	1.00	4.99	52.9
1958	1.00	4.84	51.3
1959	1.00	4.81	49.5
1960	1.00	4.72	47.8
1961	1.15	5.38	53.7
1962	1.15	5.33	51.8
1963	1.25	5.71	54.8
1964	1.25	5.64	52.9
1965	1.25	5.56	50.9
1966	1.25	5.40	48.7
1967	1.40	5.86	52.3
1968	1.60	6.45	56.2
1969	1.60	6.17	52.6
1970	1.60	5.89	49.6
1971	1.60	5.64	46.4
1972	1.60	5.48	43.3
1973	1.60	5.15	40.6
1974	2.00	5.86	47.2
1975	2.10	5.68	46.3
1976	2.30	5.89	47.3
1977	2.30	5.53	43.9
1978	2.65	5.97	46.6
1979	2.90	5.98	47.1
1980	3.10	5.73	46.6
1981	3.35	5.65	46.2
1982	3.35	5.33	43.6
1983	3.35	5.11	41.8
1984	3.35	4.90	40.3
1985	3.35	4.73	39.1
1986	3.35	4.65	38.2
1987	3.35	4.48	37.3
1988	3.35	4.31	36.1
1989	3.35	4.11	34.7
1990	3.80	4.42	38.0
1991	4.25	4.74	41.2
1992	4.25	4.61	40.2
1993	4.25	4.47	39.2
1994	4.25	4.36	38.2
1995	4.25	4.25	37.1

Adjusted for inflation using the CPI-U-X1

Source: Center on Budget and Policy Priorities

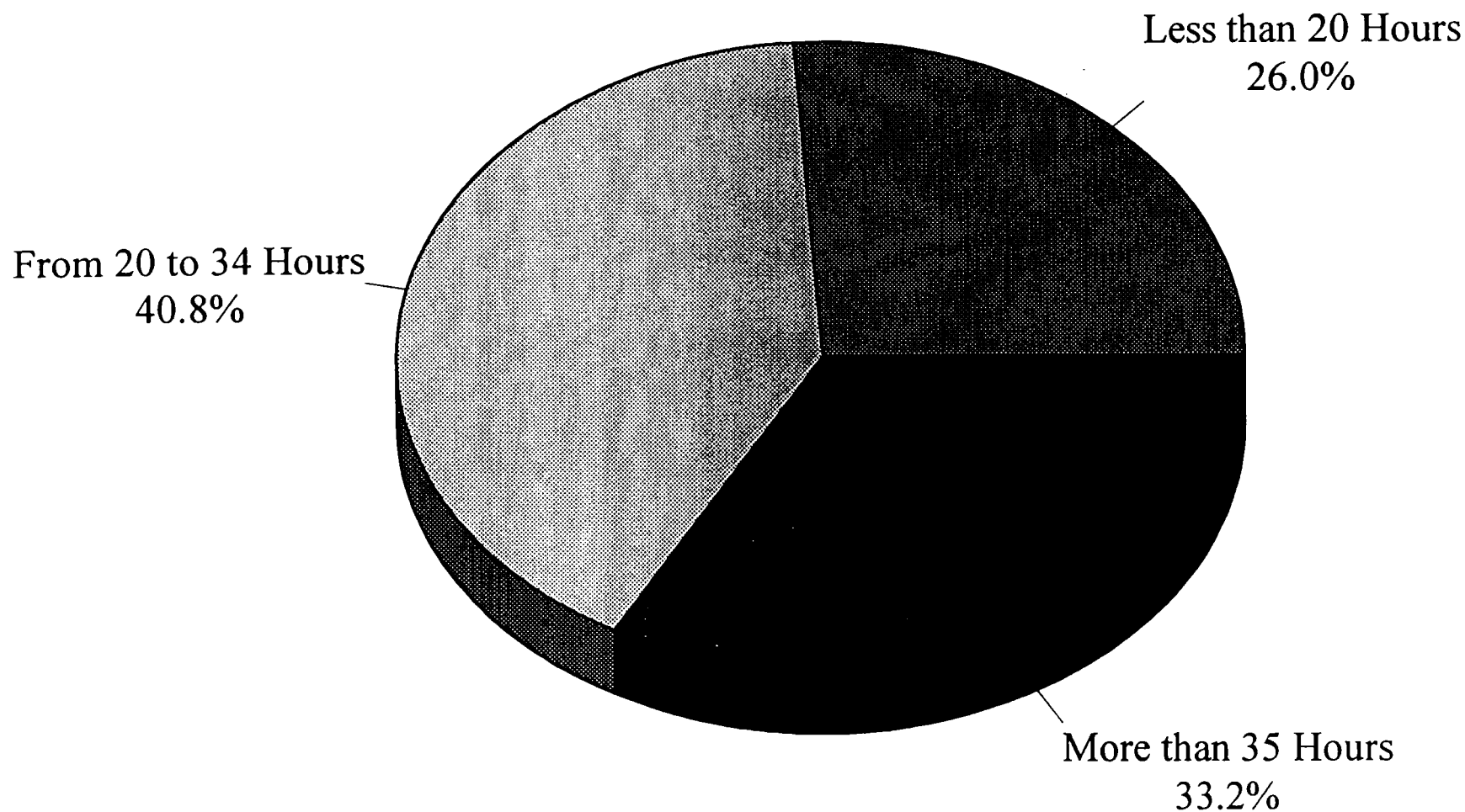
Distribution of Hourly-Paid Minimum Wage Earners by Education: 1993



Source: Bureau of Labor Statistics.

What Hours Do Minimum Wage Workers Work?

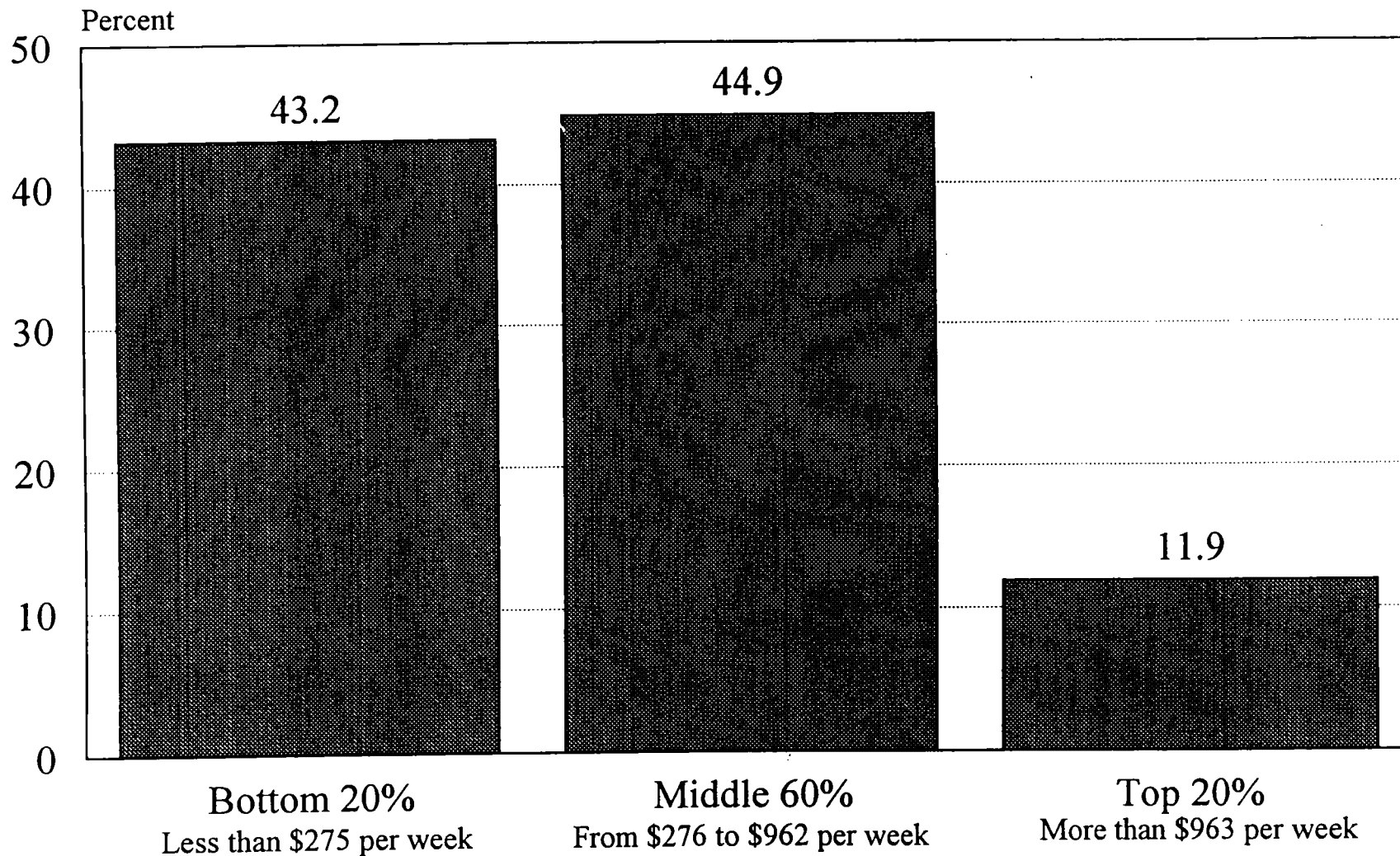
Distribution of Hourly-Paid Minimum Wage Earners by Hours Usually Worked per Week: 1993



Source: Bureau of Labor Statistics.

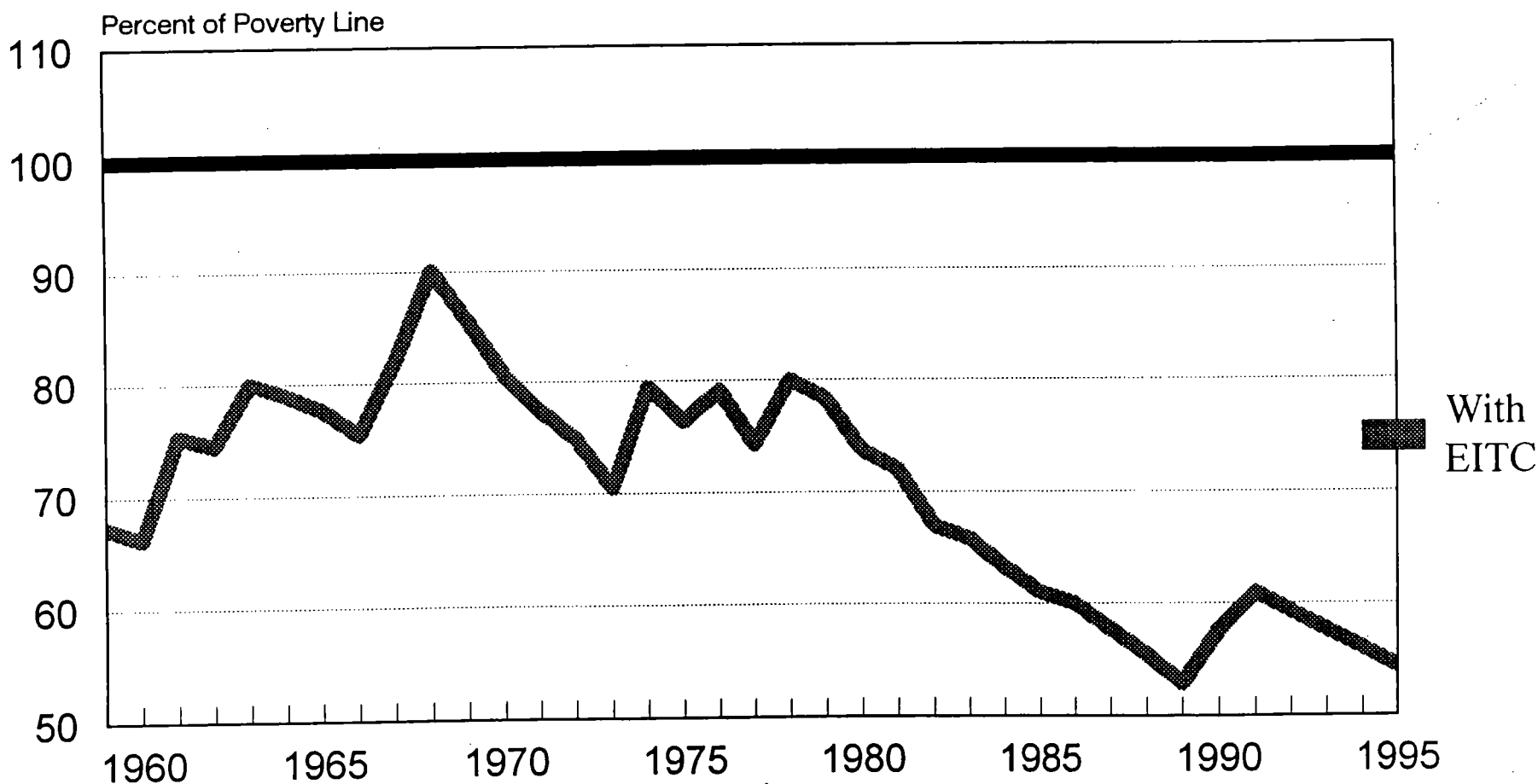
Who was Affected by the Last Minimum Wage Increase

Distribution by Family Earnings



Minimum Wage Work Does Not Lift Families Out of Poverty

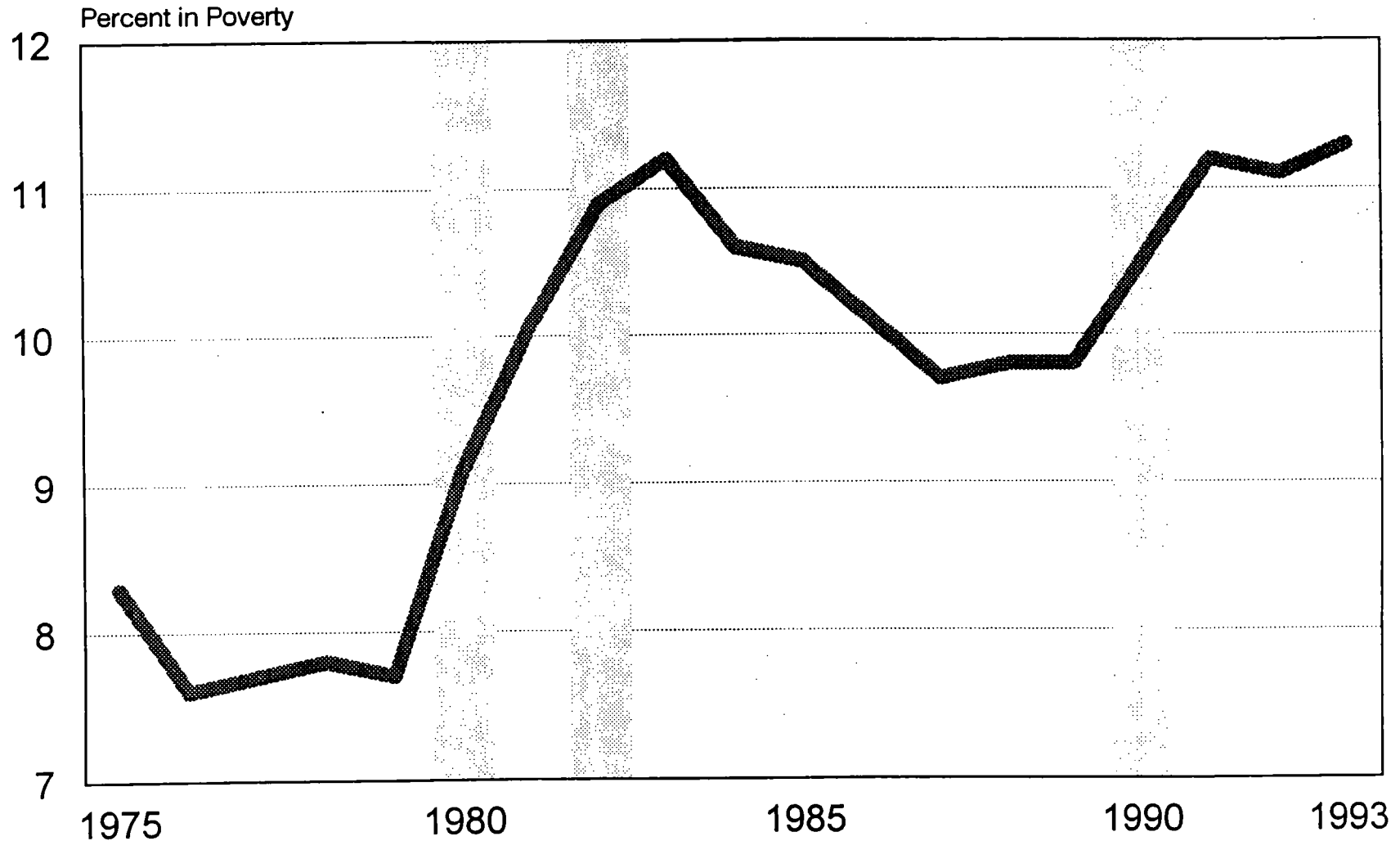
Annual Earnings at the Minimum Wage as a Percentage of the Poverty Line: 1959-1995



Note: Annual earnings for a family of four with one full-time, year-round minimum wage worker as a percentage of the four-person poverty line. The four-person poverty line for 1994 and 1995 are from Congressional Budget Office projections.

More Working Families are Poor

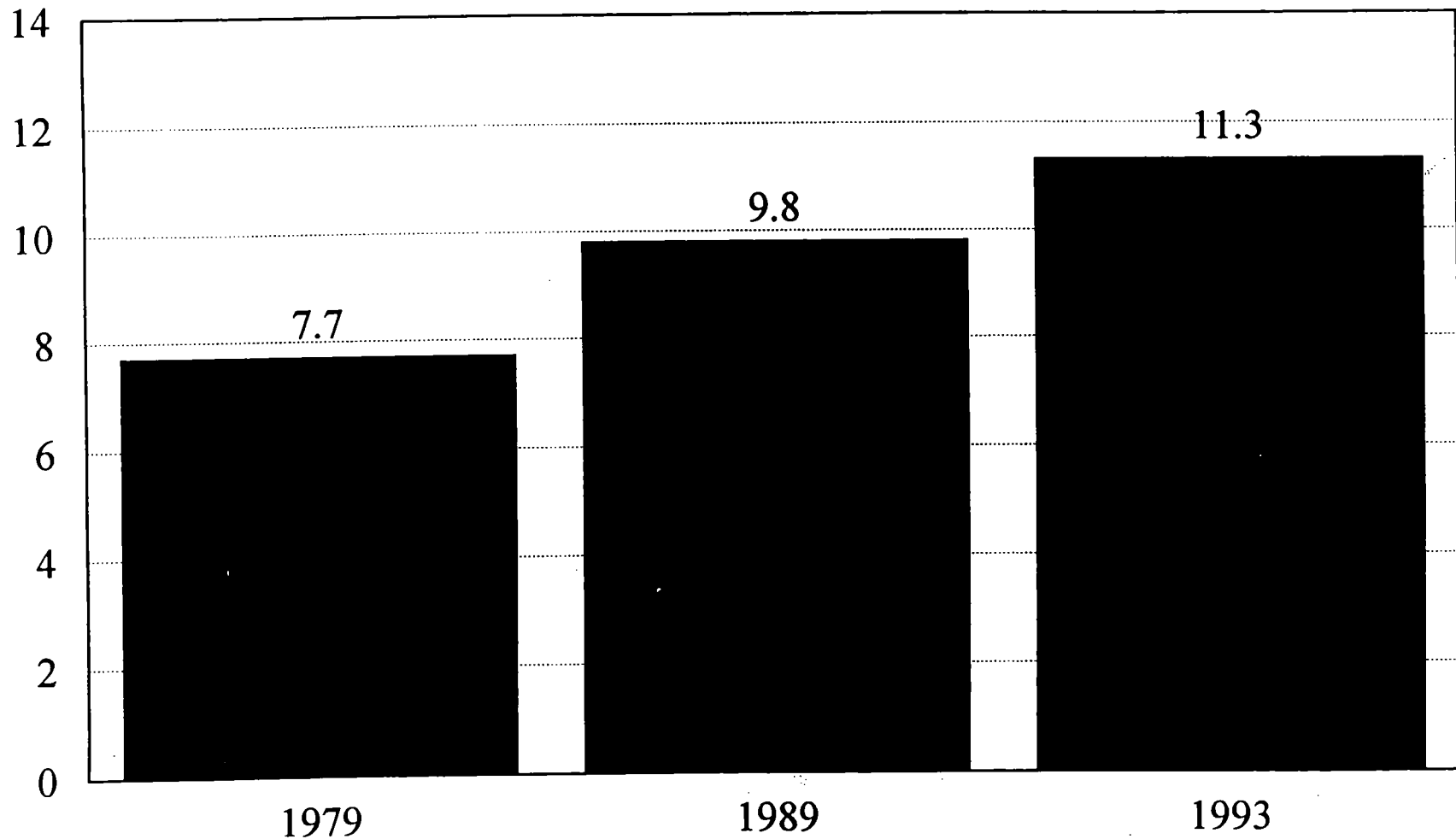
Percentage of Working Families in Poverty: 1975-1993



Source: Bureau of the Census, Current Population Survey. A working family is defined as one with children where someone in the household worked.

More Working Families are Poor

Percentage of Working Families in Poverty



Source: Bureau of the Census, Current Population Survey. A working family is defined as one with children where someone in the household worked.

STUDIES THAT CONCLUDE A MODERATE INCREASE IN THE MINIMUM WAGE HAS AN INSIGNIFICANT EFFECT ON EMPLOYMENT

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EXECUTIVE OFFICE OF THE PRESIDENT
COUNCIL OF ECONOMIC ADVISERS
WASHINGTON, D.C. 20500

THE CHAIRMAN

August 30, 1995

MEMORANDUM FOR THE PRESIDENT

FROM: JOSEPH STIGLITZ *JS*
MARTIN BAILY *MB* *File*

Subject: Proposed Executive Order Regarding Minimum Wage

Although we strongly support the Administration's proposal to raise the minimum wage, we have serious reservations about the proposed Executive Order on minimum wages for federal contractors.

- o There is, to our knowledge, no substantive body of literature to support the proposition stated in the preamble that requiring federal contractors to pay a higher minimum wage will lead to increases in efficiency *sufficient to offset the cost to federal contractors of the higher wage*. Most of the economic literature has either focused on low wage sectors, like restaurants, or discussed effects of an across the board increase in the minimum wage.
- o More generally, the effects of an increase in wages mandated in one sector of the economy (here the federal contracting sector) may be far different from those of an across the board increase in wages.
- o Most economists would argue that if federal contractors' costs would have been lowered by paying higher wages, they would have already done so. Imposing *additional* constraints on contractors would normally be expected to increase total costs. (The preamble does not contain any refutation of this argument.)
- o The magnitude of the increased costs may be significantly greater than the direct costs associated with increasing wages of workers at or near the minimum wage. The executive order will make it less attractive for firms to bid on government contracts (since it will raise costs on all production, not just on production for the government), and with fewer firms bidding, costs to the government will rise. More generally, the executive order is likely (if actively enforced) to interfere seriously with our efforts to reform government procurement policy, to make government procurement more efficient and less costly.

- o There is some chance that the increased minimum wage will reduce employment among federal contractors--even under conditions in which an across the board increase in the minimum wage would not. Federal contractors could simply substitute high-quality high wage workers. Such policies could exert downward pressure on wages in other sectors of the economy.

There are a further set of technical issues not addressed by the executive order. Will contractors be responsible for insuring that subcontractors pay the \$5.15 minimum wage? If not, this is an easy way for contractors to avoid the force of the executive order. But if contractors are responsible for enforcing minimum wages on subcontractors, it may impose significant economic costs. Each contractor will have to review the wage policies of all of its subcontractors (and its subcontractors of their subcontractors). For some, the share of federal business may be sufficiently small that they will be unwilling to revise their wage policy, necessitating entering into new contractual arrangements, presumably at greater costs. And what about products purchased on the market: does the contractor have to make sure that each product is produced by a manufacturer who pays the \$5.15 wage?

THE WHITE HOUSE

WASHINGTON

August 30, 1995

MEMORANDUM TO THE PRESIDENT

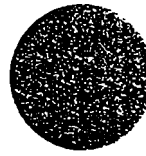
**FROM: LAURA TYSON
 BO CUTTER**

**SUBJECT: PROPOSED EXECUTIVE ORDER REGARDING MINIMUM
 WAGE**

We oppose an Executive Order requiring federal contractors to pay a minimum wage higher than the statutory minimum wage. (Gene Sperling is out of the country, but we believe he would agree.)

- . As a matter of process, we should not make as complex a decision as this one with as little analysis as has been carried out to date.
- . The proposed Executive Order would further complicate federal procurement, raising an additional barrier to working with the Federal Government, and would be inconsistent with the overall direction of federal procurement policy. We have not analyzed the long-run costs the Government would experience as firms shift away from federal work.
- . The proposed Executive Order would raise federal procurement costs, and, therefore, because budgets will not expand, may well result in lower employment derived from federal procurement.
- . The proposed Executive Order raises a number of other detailed issues we have not been able to analyze in this short a time period: How would the international operations of affected firms be treated? Would firms cut back on benefits? Are we legally able to terminate contracts?
- . Finally, the basic justification for such an Executive Order -- that it would increase overall economic efficiency -- is not supportable for a measure applying only to part of the economy. Larry Katz, who is, as you know, a leading proponent of this argument when applied to the whole economy, would probably publicly criticize it in this case.
- . We think our current minimum wage position is right and a political winner. We do not need to jeopardize our position with one action we have not thought through. If you wish, we can initiate a process immediately to develop a more thorough analysis and provide you with a better basis for a decision.

THE WHITE HOUSE
WASHINGTON



August 30, 1995

MEMORANDUM FOR ERSKINE BOWLES

AB MIKVA
LAURA TYSON
CAROL RASCO
ALICE RIVLIN
JACK QUINN
DOUG SOSNIK
PAT GRIFFIN
ALEXIS HERMAN
KITTY HIGGINS
TODD STERN
JACK LEW
STEVE KELMAN
MIKE SCHMIDT ²²⁰
DOROTHY ROBYN
ELGIE HOLSTEIN
KAREN HANCOX
SUSAN BROPHY
KATE CARR
STEVE SILVERMAN

FROM: JENNIFER O'CONNOR *mo*
SUBJECT: Minimum Wage Executive Order

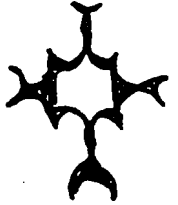
Attached is a draft Executive Order, prepared by the Department of Labor, which would require federal contractors to pay the President's proposed new minimum wage of \$5.15 per hour. The package includes a description of the pros and cons, as well as backup material.

Please have the appropriate person on your staff review the draft Executive Order and contact me with comments by 5:00pm today (Wednesday, August 30). Comments can be faxed to me at 456-7929, e-mailed to me, or called in to me at 456-6350. My apologies for the rapid turn-around, but there is discussion of moving this very quickly.

MEMORANDUM

DATE: AUGUST 29, 1995

SUBJECT: MINIMUM WAGE EXECUTIVE ORDERS



Summary

As requested, we have prepared a draft executive order that would prohibit government agencies from doing business with federal contractors that pay below \$5.15 per hour.

Attached to this memorandum are: (1) the draft executive order relating to federal contractors and the minimum wage; (2) the press packet released by the White House on February 3, 1995 accompanying your legislative proposal to increase the minimum wage; (3) an excerpt on the minimum wage from your May 19, 1995 speech for the 75th Anniversary celebration of the Labor Department's Women's Bureau; and (4) a legislative background brief describing how members of Congress voted when the minimum wage was last increased in 1989.

Message

* The nation's leading economic problems are stagnant wages and declining real incomes for working families.

* The federal government should not contribute to the wage and income problems facing working families.

* The President has presented Congress with a legislative proposal to increase the minimum wage 90 cents from its current \$4.25 per hour. This initiative would assure that people who work hard and play by the rules receive a living wage of \$5.15 per hour. Congress has refused to act.

* If Congress won't act, President Clinton will. The President will use his executive authority to guarantee a living wage --- \$5.15 per hour --- for everyone working in firms that do business with the federal government.

* At a minimum, the federal government should not do business with corporations that pay workers less than a living wage.

Discussion

I. Increasing the Minimum Wage for Employees of Federal Contractors

A. How the Executive Order Would Work

This draft executive order would establish that "[i]t is the policy of the executive branch in procuring goods and services that . . . federal agencies shall contract with companies that pay their employees no less than \$5.15 an hour." This policy would be enforced in two ways. First, every government contract entered into after the effective date of the executive order (the date you sign it) would include a clause in which the contractor agrees to pay a minimum wage of \$5.15 per hour. Second, any contractor that pays below \$5.15 could have all of its government contracts terminated. The executive order does not provide for any exceptions.

The Secretary of Labor would enforce and administer the order. If the Secretary finds that a contractor is not paying a minimum wage of \$5.15, he would transmit a finding to the heads of contracting agencies or departments who, in turn, must terminate all contracts with the contractor unless the contractor pays all of its employees at least \$5.15 per hour within a time specified by the Secretary.

Like the "striker replacement" executive order, this draft order is premised on the authority delegated to the President by Congress in the Federal Property and Administrative Services Act of 1949 "to provide for the Government an economical and efficient system for . . . procurement and supply." Some economic theories suggest that increasing the wages of low-wage workers will result in an increase in those workers' productivity and, in turn, to increases in efficiency that will offset the cost to federal contractors of the higher wages. Thus, the federal government would, according to these theories, procure its goods and services from more efficient, more economical federal contractors.

B. Possible Variations in this Executive Order

(1) Use CEO Pay as a Trigger: The executive order could be made to apply only to federal contractors that pay their chief executive officer (or other top executive) more than 100 times the lowest wage paid to their employees. This approach would dramatize the growing wage disparity in our economy. On the other hand, it undermines the central moral argument which supports raising the minimum wage: every worker is entitled to a living wage, regardless of who employs them or how much others in their organization earn. Further, using a CEO pay trigger may weaken the nexus to economical and efficient procurement, the legal prerequisite for presidential action of this type.

(2) Use Profits as a Trigger: The executive order could also be made to apply only to federal contractors that earn above average profits. This approach would juxtapose the huge economic returns being yielded by capital (e.g., the soaring stock market) with the decline in

NO-graduate

middle and working class family incomes. On the other hand, it suffers from both of the infirmities outlined above (i.e., undermining the moral argument and attenuating the procurement nexus), plus it would require an administrative apparatus to decipher each contractors' profits.

9/21/12

C. Arguments For and Against the Executive Order

(1) Pro: This draft executive order will demonstrate your commitment to increasing working families' wages (particularly for the lowest wage workers) and distinguish you from a congressional majority that refuses to even consider your legislative proposal to increase the minimum wage. The minimum wage has fallen 27% in real terms since 1979 and, without adjustment, will fall to its lowest real value in forty years in 1996. It is arguable that the growing disparity in family incomes and wealth is the most pressing issue for middle and working class families. This executive order would make your moral position clear — you will not allow the federal government to do business with any company that contributes to declining real wages for low-wage workers.

(2) Con: This executive order is premised entirely on economic theory, much of which will be difficult to explain in simple terms to the public, that is outside the mainstream of scholarly economic thought; accordingly, it is unclear whether reliable third parties will validate the arguments set forth in the preamble. Further, it is unclear whether theory alone is adequate to support an executive order. Even accepting the theories as true, it is also unclear whether the nexus between a minimum wage increase and efficient and economical procurement is sufficiently close to pass judicial scrutiny.

Preliminary research has not disclosed any executive order, outside the context of President Roosevelt's extraordinary powers during World War II, that directly sets wages for employees of federal contractors; that is, this executive order could be unprecedented. The closest analogy may be President Carter's Executive Order No. 12092 which required federal contractors to certify that they were in compliance with voluntary wage and price guidelines established by the President's Council on Wage and Price Stability. Finally, this executive order could lend support to attacks that President Clinton and the Democrats want big government. A slippery slope argument is easily made: "If Bill Clinton can require federal contractors to pay a higher minimum wage, is he going to require a pay increase for all workers? Will he require all federal contractors to follow his health plan? To finance abortions through their health plans?"

(3) Likely Constituency Responses: The labor movement and other advocates for low-wage workers will likely support the executive order. Federal contractor groups and representatives of the business community (e.g., the Chamber of Commerce, the National Association of Manufacturers), as well as the Republican congressional majority, will oppose the executive order. Since a substantially larger group of federal contractors will be affected, it is reasonable to expect a much more vigorous negative response from the business community than the striker replacement executive order evoked. Litigation and congressional

action (e.g., efforts to overturn the executive order, appropriations riders blocking enforcement of the order) will likely result.

D. The EO's Costs Are Difficult to Estimate

A very rough estimate of the costs of the executive order suggests that it will cost federal contractors not more than \$2.1 billion per year. Please note, however, that the data needed to make a precise estimate of the cost of the minimum wage executive order are not available. Estimates of worker wages and the number of workers involved do, however, permit this crude projection.

The assumptions employed to reach the above estimate likely bias the estimate upward. First, many federal contractors (e.g., construction, service) are required to pay a prevailing wage above the minimum wage by the Davis-Bacon Act and the Service Contract Act. Second, federal contractors' firms tend to be larger and, as a result, may have a smaller percentage of minimum wage workers than firms in the economy as a whole. Accordingly, the total number of workers affected by the executive order is probably smaller than that assumed in the calculations to reach the above estimate. Certain structural changes to the executive order (e.g., adding a threshold, narrowing the definition of "federal contractor") would further reduce the number of workers covered and the commensurate costs.

On the other hand, this estimate does not take into account any "ripple" effect that minimum wage increase might have on the wages of workers that currently earn \$5.15 or slightly more. The ripple effect would tend to increase the costs of the executive order to federal contractors.

II. Two Approaches to Announcing the Executive Order

Should you decide to proceed, you should consider two approaches to announcing the executive order.

You could announce the executive orders in a speech --- such as your forthcoming address to the Alameda Central Labor Council's Labor Day Picnic --- or radio address and then sign the order soon before, the same day, or soon thereafter. This approach gives the White House control over timing and press arrangements. It also provides an opportunity to brief potential supporters without tipping off opponents. On the other hand, it could inspire congressional retaliation in the appropriations/reconciliation/debt ceiling process.

Or, you could announce in a speech or radio address that you are giving Congress a 90-day (or until Christmas or New Year's Eve) deadline before which it must enact your proposed 90-cent increase in the statutory minimum wage. If it does not act by the time the deadline is reached, you would issue the executive order. This approach puts the onus

squarely on Congress' shoulders. It also allows you to wield all of your available authority to keep the minimum wage from falling to its lowest real value in 40 years (which it will in 1996 if there is no adjustment). On the other hand, this approach allows opponents time to organize and, possibly, to seek judicial intervention. It also offers words when bold action might send a stronger and clearer message.

Attachments

DRAFT 4
August 25, 1995

ENSURING THE ECONOMICAL AND EFFICIENT ADMINISTRATION AND COMPLETION OF FEDERAL GOVERNMENT CONTRACTS

PREAMBLE

Some economic theories suggest that requiring federal contractors to pay a higher minimum wage will lead to increases in efficiency that will offset the cost to federal contractors of the higher wage. The minimum wage has fallen 27% in real terms since 1979 and, without adjustment, will fall to its lowest real value in forty years at the end of 1996. Meanwhile, labor productivity has increased 17% since 1979.

These theories suggest that the productivity of low-wage workers is depressed when the minimum wage falls significantly in real terms. These conditions can lead to greater levels of "shirking" (i.e., reduced efforts by workers), higher turnover, lower morale, and longer periods in which needed jobs remain unfilled. Raising the minimum wage may lead to efficiency gains among federal contractors that employ low-wage workers by reducing shirking, lowering turnover, increasing morale, and reducing the periods of time during which needed jobs remain unfilled. In sum, productivity is lower when workers are paid an obsolete minimum wage and, as a result, the federal government receives lower quality, less reliable, and less timely goods for each taxpayer dollar. By paying a higher wage to low-wage workers, federal contractors will increase worker productivity. The federal government will procure its goods and services from more efficient, more economical federal contractors.

The market may not address this problem on its own. The problems of turnover, shirking, low morale, and extended job-slot vacancies likely result from a minimum wage which is too low to attract new workers and retain incumbent workers. However, employers cannot lure a new worker into a particular job with a higher wage without giving everyone else in that job a pay increase. Thus, in the absence of a requirement that they pay a higher wage, employers choose lower levels of employment and output rather than increasing the wages paid to all of their low-wage workers.

NOW, THEREFORE, to ensure the economical and efficient administration and completion of Federal Government contracts, and by the authority invested in me as President by the Constitution and the laws of the United States of America, including 40 U.S.C. 471 and 486(a) and 3 U.S.C. 301, it is hereby ordered as follows:

Section 1: It is the policy of the executive branch in procuring

goods and services that, to ensure the economical and efficient administration and completion of Federal Government contracts, Federal agencies shall contract only with companies that pay their employees no less than \$5.15 per hour of work. All Government contracting agencies shall include in every Government contract hereafter entered into the following provision:

"During the course of the contract the contractor agrees that all employees of the contractor will be paid no less than \$5.15 an hour."

Sec. 2.(a) The Secretary of Labor ("Secretary") may investigate any Federal contractor to determine whether the contractor is paying any of its employees less than \$5.15 per hour of work.

(b) The Secretary shall receive and may investigate complaints that the contractor is paying any employee less than \$5.15 per hour of work.

(c) The Secretary may hold such hearings, public or private, as he or she deems advisable, to determine whether any contractor is paying any employee less than \$5.15 per hour of work.

Sec. 3. (a) When the Secretary determines that a contractor has paid any employee less than \$5.15 per hour of work, the Secretary may make a finding that it is appropriate to terminate the contract for convenience. The Secretary shall transmit the finding to the head of any department or agency that contracts with the contractor. All Government contracts with the contractor shall be immediately terminated unless the contractor commences within a time specified by the Secretary to pay all of its employees no less than \$5.15 per hour of work.

(b) Each contracting agency shall cooperate with the Secretary and provide such information and assistance as the Secretary may require in the performance of the Secretary's functions under this order.

Sec. 4.(a) The Secretary shall be responsible for the administration and enforcement of this order. The Secretary may adopt such rules and regulations and issue such orders as may be deemed necessary and appropriate to achieve the purposes of this order.

(b) The Secretary may delegate any function or duty of the Secretary under this order to any officer in the Department of Labor or to any other officer in the executive branch of the Government, with the consent of the head of the department or agency in which that officer serves.

Sec. 5. This order is not intended, and should not be construed, to create any right or benefit, substantive or procedural, enforceable at law by a party against the United States, its

agencies, its officers, or its employees. The order is not intended, however, to preclude judicial review of final agency decisions in accordance with the Administrative Procedure Act, 5 U.S.C. 701 et seq.

Sec. 6. This order is effective immediately.

THE WHITE HOUSE

PRESIDENT CLINTON ANNOUNCES INCREASE IN MINIMUM WAGE

Friday, February 3, 1995

To reward work in an economy that in 1994 saw the best job growth in a decade, President Clinton will today announce his proposal to raise the minimum wage to \$5.15 an hour over two years -- through two 45 cent increases.

This news comes in the midst of more good news today for the economy under the Clinton administration. This morning, the Department of Labor reported that more than 6 million jobs have been created since President Clinton took office. In addition, the unemployment rate has dropped 20 percent to date under President Clinton.

A fact sheet and charts on the President's minimum wage proposal are attached.

House Minority Leader Richard Gephardt (D-MO) will open the announcement in the Rose Garden today, followed by Senate Minority Leader Tom Daschle (D-SD). The Vice President will then speak and introduce the President for his remarks.

-30-30-30-

REWARDING WORK: THE CASE FOR INCREASING THE MINIMUM WAGE

The President's proposal would increase the minimum wage from \$4.25 to \$5.15 over two years, through two 45 cent increases. The last increase, passed by an overwhelming, bipartisan vote in 1989, and implemented in 1990 and 1991, was also a 90 cent increase in two 45 cent stages. For a full-time, year-round worker at the minimum wage, a 90 cent increase would raise yearly income by \$1,800 -- as much as the average family spends on groceries in over 7 months.

MAINTAINING THE HISTORIC VALUE OF WORK: If the minimum wage were to stay at its current level of \$4.25, it would fall to its lowest real level in 40 years. Indeed, the real value of the minimum wage is now 27% lower than it was in 1979, and has fallen 54 cents in real value since its last increase in April 1991. The first half of the President's 90 cent proposal simply restores the minimum wage to its value at the time of the last increase.

RAISING THE MINIMUM WAGE PRIMARILY HELPS ADULT WORKERS -- MOST OF WHOM RELY ON THEIR MINIMUM WAGE JOB TO SUPPORT THEIR HOUSEHOLDS: Nearly two-thirds of minimum wage workers are adults (64%); over one-third of minimum wage workers (39%) are the sole breadwinners in their families; and the average minimum wage worker brings home half of his or her family's earnings. Thus, a rise in the minimum wage is a significant boost to the standard of living of millions of households.

REWARDS WORK OVER WELFARE: The minimum wage increase provides another crucial measure to reward work and ensure that there is a strong incentive to choose work over welfare.

NEARLY 11 MILLION WORKERS WOULD BENEFIT FROM THE PRESIDENT'S PROPOSAL TO INCREASE THE MINIMUM WAGE: Nearly 11 million workers, paid by the hour, earn between \$4.25 and \$5.14. Research indicates that an increase in the minimum wage to \$5.15 could have a "ripple" effect on the couple million workers who earn within 50 cents of the new minimum wage.

EMPIRICAL EVIDENCE SHOWS THE PRESIDENT'S PROPOSAL CAN INCREASE WAGES WITHOUT COSTING JOBS: Over a dozen empirical studies have found that moderate increases in the minimum wage do not have significant effects on employment. These studies include state-specific research that shows that large state increases in the minimum wage did not result in significant job impacts. As Nobel Laureate Robert Solow stated: "[T]he evidence of job loss is weak. And the fact that the evidence is weak suggests that the impact on jobs is small."

A 90 CENT INCREASE IN THE MINIMUM WAGE WILL LIFT A FAMILY OF FOUR OUT OF POVERTY. The dramatic extension of the Earned Income Tax Credit helped lift hundreds of thousands of working families out of poverty. Yet, by 1996, even the EITC is not enough to lift above the poverty line a family of four making the minimum wage. With the 90-cent minimum wage increase, food stamps, and the EITC, a family of four with a full-time, year round minimum wage worker would be lifted above the poverty line.

THE LAST MINIMUM WAGE INCREASE -- ALSO 90 CENTS -- GARNERED STRONG BIPARTISAN SUPPORT. In 1989, the minimum wage was passed by votes of 382 to 37 (135 Republicans) in the House, and 89 to 8 in the Senate (36 Republicans) and was supported by Senator Dole and Representative Gingrich.

Appendix Table. Value of the Minimum Wage, 1955-1995

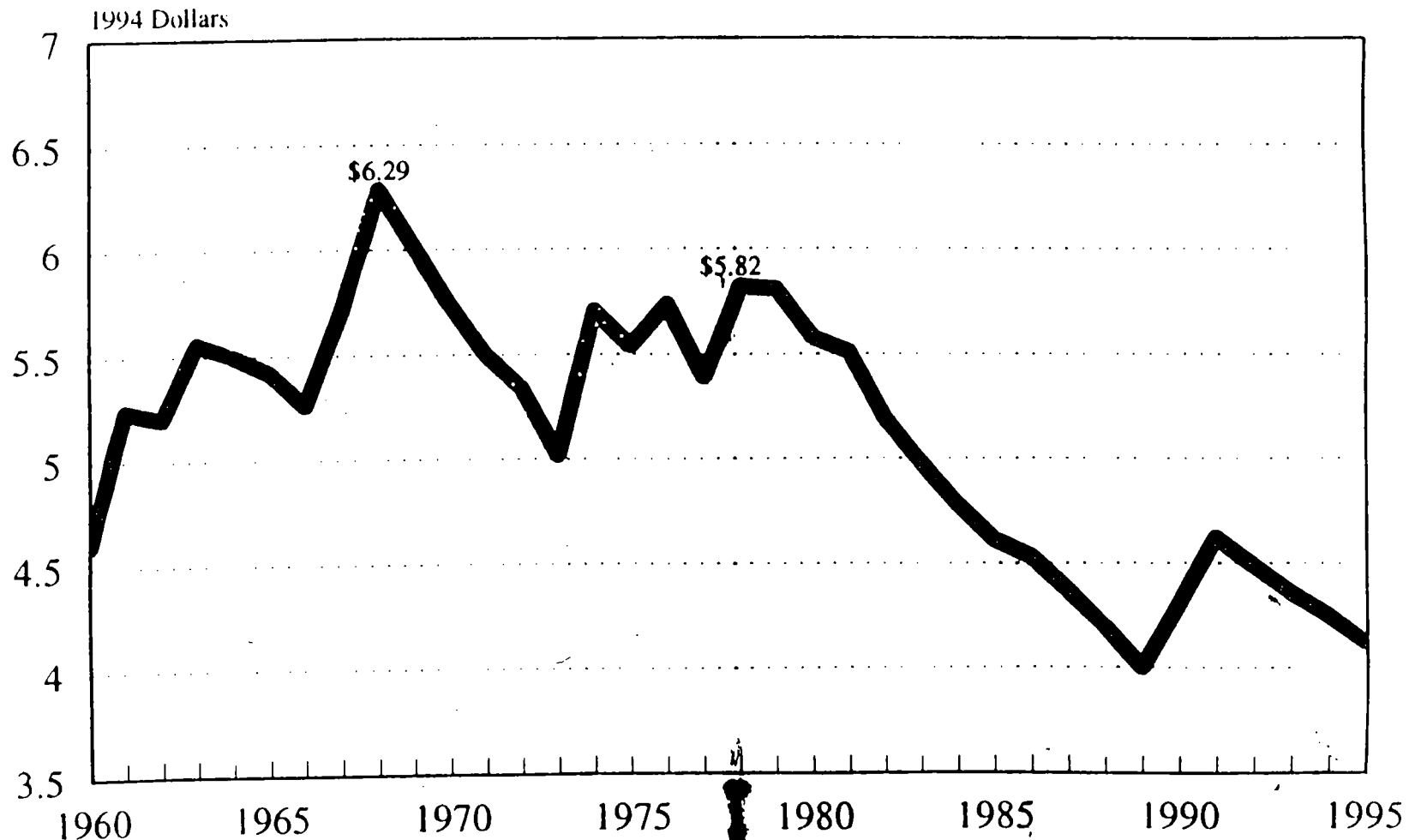
<u>Year</u>	<u>Value of the Minimum Wage, Nominal Dollars</u>	<u>Value of the Minimum Wage, 1995 Dollars*</u>	<u>Minimum Wage as a Percent of the Average Private Nonsupervisory Wage</u>
1955	\$0.75	\$3.94	43.9%
1956	1.00	5.16	55.6
1957	1.00	5.01	52.9
1958	1.00	4.87	51.3
1959	1.00	4.84	49.5
1960	1.00	4.75	47.8
1961	1.15	5.41	53.7
1962	1.15	5.36	51.8
1963	1.25	5.74	54.8
1964	1.25	5.67	53.0
1965	1.25	5.59	50.8
1966	1.25	5.43	48.8
1967	1.40	5.90	52.2
1968	1.60	6.49	56.1
1969	1.60	6.21	52.6
1970	1.60	5.92	49.5
1971	1.60	5.67	46.4
1972	1.60	5.51	43.2
1973	1.60	5.18	40.6
1974	2.00	5.89	47.2
1975	2.10	5.71	46.4
1976	2.30	5.92	47.3
1977	2.30	5.56	43.8
1978	2.65	6.00	46.6
1979	2.90	5.99	47.1
1980	3.10	5.76	46.5
1981	3.35	5.68	46.2
1982	3.35	5.36	43.6
1983	3.35	5.14	41.8
1984	3.35	4.93	40.3
1985	3.35	4.76	39.1
1986	3.35	4.67	38.2
1987	3.35	4.51	37.3
1988	3.35	4.33	36.1
1989	3.35	4.13	34.7
1990	3.80	4.44	37.9
1991	4.25	4.77	41.1
1992	4.25	4.63	40.2
1993	4.25	4.50	39.2
1994	4.25	4.38	n/a
1995	4.25	4.25	n/a

*Adjusted for inflation using the CPI-U-X1.

Source: Center on Budget and Policy Priorities

The Real Minimum Wage

1960-1995



NOTE: Minimum wage is in 1994 CPI-U-X1 Dollars. The inflation rate for 1995 is assumed to be 3.2 percent.

THE WHITE HOUSE
Office of the Press Secretary

For Immediate Release

May 19, 1995

REMARKS BY THE PRESIDENT
AT WOMEN'S BUREAU RECEPTION

The South Lawn

5:38 P.M. EDT

THE PRESIDENT: Thank you very much.

Sitting here listening to my marvelous wife speak, I was thinking, you know, I've been seeing her lately long distance, on Oprah Winfrey and on the -- (laughter) -- Morning Show this morning. And I thought, boy, I'm glad she lives here. (Laughter and applause.)

I want to thank Secretary Reich and the Women's Bureau Director, Karen Nussbaum. She has done a wonderful job. I am very grateful to her and to him. (Applause.)

. . . . But I think it's important that we recognize that women in the workplace are caught in a lot of cross-currents today, because all American workers, or at least more than half of us, are working longer hours for the same or lower pay that we were making 10 years ago. And therefore, more and more parents are working harder for the same or less and spending less time with their children. Women feel this pressure very deeply insofar as they have either sole, primary or even just half of the responsibility for taking care of their children as well as earning a living. Because male workers over the age of 45, on average, have lost 14 percent of their earning power in the last 10 years, women in the work force and in the home feel the anxiety of their husband's sense of loss and insecurity and frustration and anger.

What is causing all this and what are we to do about it? Well, what is causing it all is the impact of the global economy and the dramatic revolution in technology on our society -- opening up all kinds of new changes in ways that are perfectly wonderful if you can access them, but terrifying if you cannot.

For example -- we don't have the figures yet on '94, but I think '94 will confirm '93's trend -- in 1993 we had the

largest number of new businesses started in America in any year in history, and the largest number of new millionaires in America in any year in history. And that is a good thing. That is a good thing. And that is happening because so many of us are now able to access the world of the future. Many of you in this room are part of the trend toward a brighter, bigger, broader tomorrow.

But there is also a fault line in our society that is splitting the middle class apart, putting unbearable pressures on families, making them less secure and making them less able to live up to the fullest of their abilities. You know it, and I know it.

That's why the Family and Medical Leave Law was important. If people are going to be working for smaller companies, not bigger ones, and moving around, at least they ought to know they can take some time off without losing a job if there's someone sick in their family or if a baby is born or some other emergency arises. (Applause.) That's why it was important. (Applause.)

That's why the efforts of the Secretary of Labor and the Secretary of Education to create a fabric, a seamless fabric of lifelong learning -- whenever people lose their jobs or feel that they're underemployed -- it's terribly important. (Applause.)

And that's why I believe it is especially important to women that we raise the minimum wage this year. (Applause.) Women represent three out of five minimum wage workers, but only half the work force.

I have done everything I could to create a climate in which people are encouraged to choose work over welfare, in which people are encouraged to be successful parents and successful workers. I believe that. That's what the Earned Income Tax Credit was all about in 1993. (Applause.)

Let me tell you what that meant -- that meant this year that the average family of four with an income under \$27,000 got a \$1,000 tax cut below what they paid before this administration came into office. And it means three years from now, if the Congress will stick with it and not repeal it, we will be able to say that no one who works full-time and has children at home, when they go home from work, will live below the poverty line. That is the best war against welfare we could wage. (Applause.)

But it isn't enough. If we do not raise the minimum wage this year, next year it will be in real dollar terms, the lowest it has been in 40 years. Now that is not my idea of what the 21st century American economy is all about. I want a smart work, high-wage economy, not a hard-work, low-wage economy. And

the working women of America and their children and their husbands deserve it as well. (Applause.)

You know, I have a -- I don't get to watch a lot of kind of extra television, but the other night, just by accident, I was watching a news program where a special was being done on the minimum wage. And -- I don't even know if it was a national program or one of the state networks around here, but they went down south to a town that had a lot of minimum wage workers. And they went in this plant to interview a remarkable woman who worked in this plant at a minimum wage. And they said to this lady: You know, your employer says if we raise the minimum wage that they'll either have to lay people off or put more money into machinery and reduce their employment long-term. What do you say to that? I could not have written the script. (Laughter.) This lady sort of threw her shoulders back and looked into the eyes of the television reporter and said: Honey, I'll take my chances. (Laughter and applause.)

If we are going to bring our budget deficit into balance, which will be good for all of us; if we're going to have to over a period of years cut back on expenditures that the government used to make, that makes it even more important for people who do go out into the private sector and work full-time, play by the rules, and want to make their own way without public assistance, to be rewarded for that work. This is a huge issue.
. . . .

. . . . I thank you all. Please stay around. Have a good time. We're delighted to see you. Good-bye. Thank you. (Applause.)

END 5:58 P.M. EDT

Legislative Background - Minimum Wage - 1989

* Last increase (from \$3.35/hour to \$3.80 on 4/1/90 and \$4.25/hour on 4/1/91) passed Congress in 1989 in a bi-partisan agreement following an earlier veto by **President Bush**:

- o Senate Vote: 89 - 8
 - o House Vote: 382- 37
- (see attached list of votes)

* **President Bush** proposed the increase to \$4.25 an hour and refused to accept any increase above that;

* **President Bush** had vetoed a Democratic attempt to raise minimum wage to \$4.55 over three years and Congress failed to override the veto - his first successful veto as President;

* **Cong. Goodling** (R-PA) was quoted at the time as stating that Republican lawmakers were "uneasy" about President Bush's position and "don't want to go to the wall a second time." Cong. Goodling introduced his own minimum wage bill that proposed a three year phase to \$4.25/hour, a training wage and expansion of the earned-income tax credit. He voted for **final passage** of the minimum wage increase;

* The **Labor Secretary** at the time was **Elizabeth Dole**;

* The Senate and the House were both controlled by Democrats;

* The bill signed by President Bush included a training wage for teenagers between 16 and 19;

* **Sen. Dole** (R-Kan) (voted for final passage)

"I think that many of us feel that this is not an issue where we ought to be standing and holding up anybody's getting a 30- to 40-cents-an-hour- increase, at the same time we are talking about capital gains. I never thought the Republican Party should stand for squeezing every last nickel from the minimum wage."

* The Senate tabled an amendment by Sen. Hatch that would have barred Congress from passing any legislation that would increase the costs of certain small business (the small business exemption from the minimum wage was increased to cover small businesses with sales of less than \$500,000 (from \$362,500) by the bill itself;

* The Senate tabled an amendment by Sen. Gramm (R-Tex) which would have removed the provision which prevented farmers from using the training wage for teenage farmworkers;

* Much of the current Senate and House Leadership voted for minimum wage increase in 1989 - including Dole, Lott, Gramm, Gingrich and Kassebaum. However, Armey, Delay, Livingston - voted against (see attached list);

* Key Senate Republicans supporters in 1989 (supported an attempt at a Dem. compromise)

Sen. Cohen (R-Maine)
Sen. Hatfield (R-Ore.)
Sen. Jeffords (R-Vermont)
Sen. Packwood (R-Ore.)
Sen. Pressler (R-SD)
Sen. Specter (R-Penn)

* Key Senate Republicans in Opposition:

Sen. Mack (R-Florida)
Sen. Nickles (R-OK)
Sen. Helms (R-NC)
Sen. Hatch (R-Utah)

* Governor Wilson voted for the minimum wage increase as a Senator in 1989.

* Senate Democrats of concern (voted against Dem. compromise at \$4.55 or cloture in 1989):

Sen. Hollings (D-SC)
Sen. Bennett Johnston (D-La)
Sen. Heflin (D-Al)
Sen. Exon (D - NE)

Sen. Campbell (D-Col) (voted to uphold Bush's veto in House)

Senators in the Democratic and Republican Leadership their votes
on H.R. 2710 final passage (minimum wage).

SENATE LEADERSHIP

YES

Democrats

Breaux -- Deputy Whip
Byrd -- Ranking on Appropriations
Daschle -- Minority Leader
Ford -- Minority Whip
Harkin -- Ranking on the Appropriations, Labor Subcommittee
Kennedy -- Ranking on the Labor Committee
Mikulski -- Secretary of the Democratic Party
Reid -- Co-Chair of the Democratic Policy Committee

Republicans

Cochran -- Chair Republican Conference
Dole -- Majority Leader
D'Amato -- Campaign Committee Chair
Lott -- Majority Whip
Kassebaum -- Chairman of Labor Committee
Hatfield -- Chair of Appropriations Committee
Specter -- Chair of the Appropriations Labor Subcommittee

NO

Democrats

None

Republicans

Mack -- Policy Committee
Nickles -- Chair of the Republican Policy Committee

SENATE VOTES ON HR 2710 (Minimum wage -- Final Passage)
Members that are still in the Senate for the 104th Congress)

YES

Democrats

Biden
Bingamen
Bradley
Breaux
Bryan
Bumpers
Byrd
Conrad
Daschle
Dodd
Exon
Ford
Glenn
Graham
Harkin
Heflin
Hollings
Inouye
Johnston
Kennedy
Kerrey
Kerry
Kohl
Lautenberg
Leahy
Levin
Lieberman
Mikulski
Moynihan
Nunn
Pell
Pryor
Reid
Robb
Rockefeller
Sarbanes
Shelby
Simon

Additional Democratic Senator that did not vote or express a
position
Baucus

SENATE VOTES ON HR 2710 (Minimum wage -- Final Passage)
Members that are still in the Senate for the 104th Congress)

YES

Republicans

Bond
Burns
Chafee
Coats
Cochran
Cohen
D'Amato
Dole
Domenici
Gorton
Gramm
Grassley
Hatfield
Jeffords
Kassebaum
Lott
Lugar
McCain
McConnell
Murkowski
Packwood
Pressler
Roth
Simpson
Specter
Stevens
Thurmond
Warner

SENATE VOTES ON HR 2710 (Minimum wage -- Final Passage)
Members that are still in the Senate for the 104th Congress)

NO

Democrats (0)

Republicans

Hatch

Helms

Mack

Nickles

HOUSE LEADERSHIP VOTES ON FINAL PASSAGE OF HR 2710

HOUSE

Democrats

YES

Gephardt
Bonior
Clay
Obey

NO

None

Repubilcans

YES

Gingrich
Goodling
Porter

NO

Armey
Delay
Livingston

HOUSE VOTES ON FINAL PASSAGE OF HR 2710 (MINIMUM WAGE) FOR
MEMBERS OF THE 104TH CONGRESS

YES

Democrats

A

Ackerman

B

Beilenson

Berman

Bevill

Bonior

Borski

Boucher

Browder

Brown, George

Bryant, John

Burton, Dan

C

Cardin

Chapman

Clay

Clement

Coleman

Collins, Cardiss

Condit

Costello

Coyne

D

Dellums

DeFazio

de la Garza

Dicks

Dingell

Dixon

Durbin

E

Engel

Evans

F

Fazio
Flake
Foglietta
Frank
Frost

G

Gejdenson
Gephardt
Geren
Gibbons
Gonzalez
Gordon

H

Hall, Ralph
Hall, Tony
Hamilton
Hayes
Hefner
Hoyer

J

Jacobs
Johnson, Tim
Johnston, Harry

K

Kanjorski
Kaptur
Kennedy, Joe
Kennelly
Kildee
Kleczka

L

LaFalce
Lantos
Laughlin
Levin
Lewis, John
Lipinski
Lowey

M

Manton
Markey
Martinez
Matsui
McDermott
McNulty
Mineta
Mfume
Mollohan
Montgomery
Murtha

N

Neal, Richard

O

Oberstar
Obey
Ortiz
Owens, Major

P

Pallone
Parker
Payne, Donald
Payne, Lewis
Pelosi
Pickett
Poshard

R

Rahall
Rangel
Richardson
Rose

S

Sabo
Sawyer
Schroeder
Schumer
Sisisky
Skaggs
Skelton
Slaughter
Spratt
Stark
Stenholm
Stokes
Studds

T

Tanner, John
Taylor, Gene
Tauzin
Torres
Torricelli
Towns
Traficant

V

Vento
Visclosky
Volkmer

W

Waxman
Williams, Pat
Wilson
Wise
Wyden

Y

Yates

Additional Democrats that did not vote yes or no

Did not vote or make a position known

Conyers
Moakley

Announced For

Ford, Harold

HOUSE MEMBERS THAT VOTED FOR FINAL PASSAGE OF HR 2710 (minimum wage) that are in the 104th Congress

YES

Republicans

B

Ballenger
Bateman
Bliley
Boehlert
Bereuter
Bilirakis

C

Coble
Clinger

D

Duncan

E

Emerson

F

Fields

G

Gekas
Gillmor
Gilman
Gingrich
Goodling
Gunderson

H

Hastert
Herger
Houghton
Hunter
Hyde

J

Johnson, Nancy

K

Kasich
Kolbe

L

Leach
Lewis, Jerry
Lightfoot

M

McCrery
McDade
Meyers, Jan
Moorhead
Morella
Myers, John

P

Packard
Petri
Porter

Q

Quillen

R

Regula
Roberts, Pat
Rogers
Ros-Lehtinen
Roth
Roukema

S

Saxton
Schaefer
Schiff
Sensenbrenner
Shaw
Shays
Shuster
Skeen
Smith, Christopher
Smith Lamar
Soloman
Spence
Stearns

T

Thomas, William

U

Upton

V

Vucanvoich

W

Walker

Walsh

Weldon, Curt

Wolf

Y

Young, Don

Young, C.W. "Bill"

Additional Republican members that did not vote yes or no

Did not vote or express an opinion

Molinari

HOUSE VOTES ON FINAL PASSAGE OF HR 2710 (MINIMUM WAGE) FOR ALL
MEMBERS OF THE 104TH CONGRESS

NO

Democrats

Miller, George (California)

Republicans

A

Archer

Armey

B

Baker, Richard

Barton

Bunning

Burton

C

Callahan

Crane

Combest

Cox

D

DeLay

Dornan

Drier

F

Fawell

G

Gallegly

Goss

H

Hansen
Hancock
Hefley
Hunter

L

Livingston

M

McCollum

R

Rohrabacher

O

Oxley

P

Paxon

S

Stump

MEMBERS OF THE SENATE THAT WERE IN THE HOUSE AND VOTED
ON FINAL PASSAGE OF HR 2710

YES -- Democrats

Boxer
Akaka

YES -- REPUBLICANS

Craig
Snowe
DeWine
Inhofe

File: Min Wage

MEMORANDUM FOR JOSEPH STIGLITZ
 MARTIN BAILY
 ALICIA MUNNELL
FROM TOM KANE
RE UPDATE ON IMPACTS OF THE MINIMUM WAGE
DATE JANUARY 19, 1996

The purpose of this memorandum is to update you on several recent developments in the ongoing debate over the impact of the minimum wage on employment and school enrollment.

1. *New Neumark-Wascher Evidence*

The Neumark-Wascher research reporting negative effects of the New Jersey minimum wage hike was based upon actual payroll data for a subsample of the restaurants surveyed by Card and Krueger. The payroll data were provided to Neumark and Wascher by the Employment Policies Institute (EmpPI, not to be confused with the Economic Policy Institute). Although no direct evidence suggests that the sample supplied to Neumark and Wascher was specifically selected to yield negative employment impacts, suspicions have lingered, given EmpPI's connections to the fast-food industry.

Because of those suspicions, Neumark and Wascher collected payroll data from a second sample of fast-food restaurants in New Jersey and Pennsylvania. The new paper also reports significant negative impacts of the New Jersey minimum wage increase on employment. Unfortunately, throughout most of the paper, they simply pool their new data with the data supplied to them by EmpPI. However, in the text of the paper they note that they would have found a negative, but *insignificant* effect, if they had used the new data alone.

Neumark and Wascher defend the decision to pool their new data with the EmpPI data by arguing that one could not reject the hypothesis that the point estimates yielded by the two data-sets were the same. However, the samples do not seem to have been drawn from the same distributions, because one could reject the hypothesis that the residual error was the same in the two data-sets. (The suspect EmpPI data showed much more variation than the new data collected by Neumark and Wascher.) Unfortunately, the new sample did not include those firms in the original EmpPI data and, therefore, may not be representative by itself.

Therefore, we have three estimates of the effect of the New Jersey minimum wage increase on employment in fast-food restaurants:

1. Card and Krueger's positive and significant estimate based upon a phone survey of firms. The Card and Krueger survey has been attacked for asking imprecise questions about employment which proved more variable than actual payroll records. However, such criticisms may be misplaced. Although it may have made inference more difficult, measurement error in a dependent variable would not necessarily lead to bias unless, for some reason, employment growth was overstated in New Jersey.
2. An insignificant negative impact based upon new payroll data collected by Neumark and Wascher.
3. A significant negative estimate based upon the EmpPI sample which has been a subject of skepticism.

The most recent Neumark and Wascher paper suggests an elasticity of $-.24$. With a 12% percent increase in the minimum wage from \$4.25 to \$4.75 would imply only a 2 percent decline in employment in the fast-food industry, and probably smaller declines in industries less dependent upon minimum-wage workers. Therefore, even using the Neumark and Wascher results, it seems fair to say that the employment effects would be small. Furthermore, with any demand elasticity greater than -1 , an increase in the minimum wage will raise total earnings (wage times hours) of low-wage workers, since a 10 percent increase in wage results in less than 10 percent decline in employment.

2. *School Enrollment Effects*

In a recent editorial in the *Wall Street Journal* (attached), Robert Barro highlights several other papers by Neumark and Wascher arguing that increases in the minimum wage lead some youth to drop out of school. The school enrollment impacts are vital since Neumark and Wascher have shown that it is primarily when one includes their measure of school enrollment as a regressor in a state panel analysis that one finds that the effect of the minimum wage is negative and significant.

Their work on school enrollment has been criticized primarily because their measure of school enrollment, excludes those who are in school but who report their major activity as "working". If an increase in the minimum wage encourages some youth to work a few more hours, students may switch their response on the major activity question from "school" to "work", although school enrollment may not have changed.

The October CPS, in contrast, identifies school enrollment independent of labor force activity. A recent analysis by Bill Evans from the University of Maryland and Mark Turner

from the Urban Institute using October CPS data has suggested no statistically significant effect of the minimum wage on school enrollment. Further, using the alternative measure of school enrollment, the panel analysis reveals no statistically significant effect of the minimum wage on employment. Neumark and Wascher are currently formulating a response to this critique.

It seems ironic that Barro would hold up Neumark and Wascher's result as saving the conventional wisdom, since a drop in school enrollment after an increase in the minimum wage would also seem to be inconsistent with neoclassical theory. If youth were simply paid their productivity, an increase in the minimum wage would not raise anyone's earnings potential and, therefore, would not lead anyone to drop out of school to take advantage of a "higher wage." It would simply eliminate any employment prospects for those with productivity below the minimum wage. In fact, I would think that the simplest neoclassical model would lead one to expect an increase in school enrollment with a rise in the minimum wage: Those who could no longer find work because they were laid off would have their opportunity costs lowered and may find schooling a worthwhile investment. Employment would decline and school enrollment and idleness would increase.

Nevertheless, I think the jury is still out on the school enrollment effects. Although I do not have a good story, in my own work with the CPS, I have noticed declines in school enrollment in California relative to other states after the April 1988 minimum wage increase in California. The finding is the same using administrative data on community college enrollments.

As new evidence is brought to light, I will keep you posted.

Higher Minimum Wage, Higher Dropout Rate

By ROBERT J. BARRO

Economists are known for their controversies, especially in macroeconomic policy. But agreements are more common in microeconomics, an example until recently being the consensus about the negative relation between minimum-wage rates and employment of low-wage workers.

This happy consensus about minimum wages was shattered a few years ago by David Card, an economics professor at Princeton, and Alan Krueger, who recently returned to Princeton from a stint as chief economist of the Labor Department. They reported in a series of empirical studies that, instead of lowering employment of teenagers and other low-wage workers, higher minimum-wage rates either had no effect or actually raised employment. This counterintuitive challenge to the conventional wisdom stimulated a good deal of reasonably effective, not to mention vituperative, criticism. Especially prominent among the critics is the team of Finis Welch, a professor in Phil Gramm's old economics department at Texas A&M, and Kevin Murphy, a professor at the Chicago Business School.

Heroes of the Field

Now that the dust has more or less settled, it appears that the two pairs of big guns, Card-Krueger and Welch-Murphy, have both been damaged by the battle. Meanwhile, two lesser-known economists, David Neumark of Michigan State and William Wascher of the Federal Reserve Board, have emerged through a series of careful studies as the heroes of the field. Research is still continuing, but Messrs. Neumark and Wascher's recent work provides the most reliable evidence thus far.

Messrs. Neumark and Wascher have argued that to assess the impact of minimum wages on teenage employment one also has to understand the interaction with teenage school enrollment. Their latest research, detailed in an unpublished July 1995 paper, shows from data on individuals that higher minimum wages have a negative effect on teenage school enrollment. Apparently, many teenagers who previously classified school as their major activity are induced by the higher minimum wage to leave school for full-time work. By contrast, for teenagers who were originally working but not in school, a higher minimum wage tends to reduce employment and raise idleness (out of school and not working).

The overall effect of a higher minimum wage on employment and work hours therefore involves two offsetting forces. While the net negative effect on employment is small, this apparently minor response masks some disturbing composi-

tional changes. The teenagers who lose jobs and become idle tend to be the more disadvantaged, notably blacks and Hispanics, who were initially not in school. Those who gain jobs or increase hours of work tend to be the more advantaged, notably nonblacks/non-Hispanics, who were initially in school but are induced to drop out to secure higher-wage jobs.

As a welfare program, the minimum wage misses the mark because it worsens the status of the most disadvantaged youths. It is also debatable whether credit should be given to the greater work hours and employment (at higher wages) of teenagers who are induced to leave school. A classical liberal would argue that these school-leavers must be better off, but an increase in the school dropout rate was probably not the intended consequence of the minimum-wage program.

Of course, these latest results were not

ward, Lawrence Katz, who was Alan Krueger's predecessor as chief economist at the Labor Department) objected to Messrs. Neumark and Wascher's treatment of teenage school enrollment, and all the authors agree that this treatment is important for isolating the effect of minimum wages on teenage employment. The main criticism is that teenage school enrollment and employment are jointly determined by minimum wages and other variables, and the effect of minimum wages on employment cannot be reliably estimated just by including a measure of enrollment as an explanatory variable for employment.

The Card-Katz-Krueger comment would have been more compelling if it had not also contained several other, erroneous objections to the Neumark-Wascher study. These points involve the relation between the minimum-wage variable and

employment—the sample attrition may systematically affect the results. However, Messrs. Neumark and Wascher argue, plausibly, that this effect would probably cause their estimates to understate the true influence of minimum wages.)

An annoying feature of the Card-Krueger research is their eagerness to use their findings to discredit the law of demand. Although the negative effect of price on the quantity demanded is not a mathematical theorem, it is an empirical law that has avoided any clear violations in all of recorded history. (Even the potato during the Irish famine—which was claimed to be a "Giffen good," for which the demand increased with the price—does not stand up as a counterexample.) Thus, it shows extraordinary arrogance to use tenuous empirical evidence—such as that based on their poorly designed survey of fast-food restaurants in New Jersey and Pennsylvania—to proclaim the first documented case in which demand curves fail to slope down. A more reasonable view is that the law of demand is just fine, and the Card-Krueger empirical analysis needs repairs.

Political Support

In the end, one has to wonder about the sources of political support for minimum-wage legislation. One clear beneficiary is labor unions, which tend to represent high-wage workers. This group favors high minimum wages to lessen the competition from low-wage workers. By effectively ruling out the hiring of some low-skilled persons, minimum wages tend to raise wages and employment for those with high skills. (In this respect, the support for minimum wages tends to go along with advocacy for restrictions on trade with and immigration from low-wage countries.)

Yet the strength of the political support for minimum wages seems to reflect something more: an alliance of interest groups such as labor unions with misguided liberals who honestly regard minimum wages as a form of welfare program. An optimistic view therefore is that liberals could be persuaded that minimum wages actually harm the least well off workers and appear specifically to be antiblack and anti-Hispanic. Then liberals might drop their support for minimum wages, and the clout from interest groups alone would perhaps be insufficient to sustain the program. The pessimistic view, however, is that it is pretty difficult to convert a duped liberal.

Mr. Barro, a Wall Street Journal contributing editor, is a professor of economics at Harvard and a senior fellow of the Hoover Institution.

Messrs. Neumark and Wascher's research shows that higher minimum wages reduce teenage school enrollment and increase idleness among those previously working.

the beginning of the recent research on the employment effects of minimum wages. One of the most well-known studies is the Card-Krueger investigation of employment at fast-food restaurants in New Jersey and Pennsylvania around the time of New Jersey's 1992 minimum-wage increase. They found from a telephone survey of "managers" that New Jersey's employment rose relative to Pennsylvania's. Hence, they concluded that, if anything, a higher minimum wage stimulated the employment of low-wage workers.

Finis Welch has convincingly criticized the quality of the underlying survey design, and Messrs. Neumark and Wascher have shown that the results are different—and show the conventional small negative effect of higher minimum wages on employment—if more accurate data from payrolls are substituted for the dubious survey information. So far as I know, the main reaction from the Card-Krueger camp is that the payroll data must be tainted because a portion of the information was collected by the Employment Policies Institute (EPI), an employers' organization that opposes minimum-wage legislation. Messrs. Neumark and Wascher have, however, verified the EPI figures and shown that the basic message is similar if these data are omitted from the analysis.

In the April 1994 Industrial and Labor Relations Review, Messrs. Card and Krueger (joined by my colleague at Har-

vard, Lawrence Katz, who was Alan Krueger's predecessor as chief economist at the Labor Department) objected to Messrs. Neumark and Wascher's treatment of teenage school enrollment, and whether factors that influence teenage school enrollment should matter at all for employment. The Neumark-Wascher reply (also in the April 1994 ILRR) effectively disposed of these secondary criticisms.

Messrs. Neumark and Wascher's recent research has attempted to deal with the critical interaction between enrollment and employment of teenagers. The best approach to date is the analysis of how minimum wages influence transitions for individually observed teenagers among four categories: in-school/employed, in-school/not-employed, not-in-school/employed, and not-in-school/not-employed. As discussed before, this analysis reveals that the main effects are for higher minimum wages to induce some teenagers to move from in-school/employed and to a lesser extent from in-school/not-employed to not-in-school/employed, and others to move from not-in-school/employed to not-in-school/not-employed. That is, higher minimum wages reduce teenage school enrollment and increase idleness among those previously working.

(Probably the main shortcoming of this analysis is that roughly one-third of the teenage sample each year cannot be matched with data from the previous year. Since this matching problem tends to reflect changes in residence—which often go along with shifts in status for schooling and

A Call for Legislative Inaction

By DEREK M. JOHNSON

Once again Congress and the president have deadlocked over the issue of welfare

respected—the necessary predicate to economic growth is established. There are those who believe that much of this

send these folks to Washington they try to help all of us (and don't succeed at all) or just a few of us (and succeed all too well).

rect the problems of the old legislation. But even if we correctly reformed the old legislation, the fundamental economic prob-

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pages

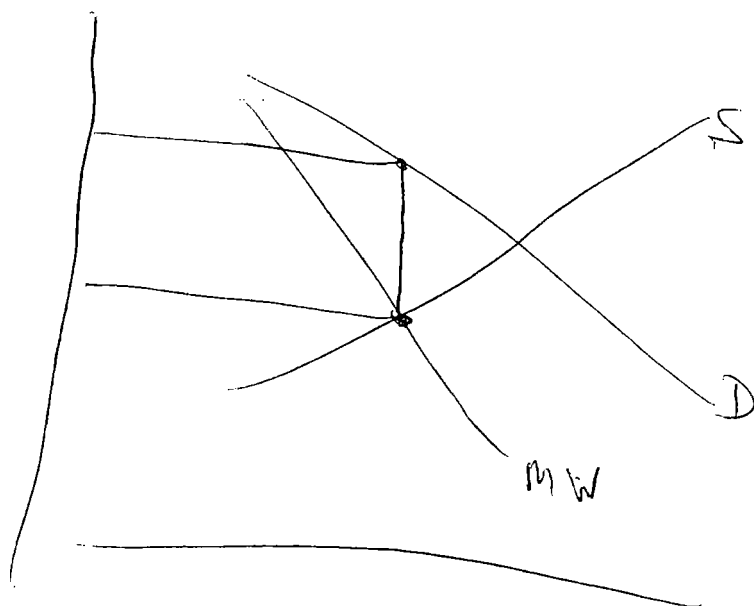
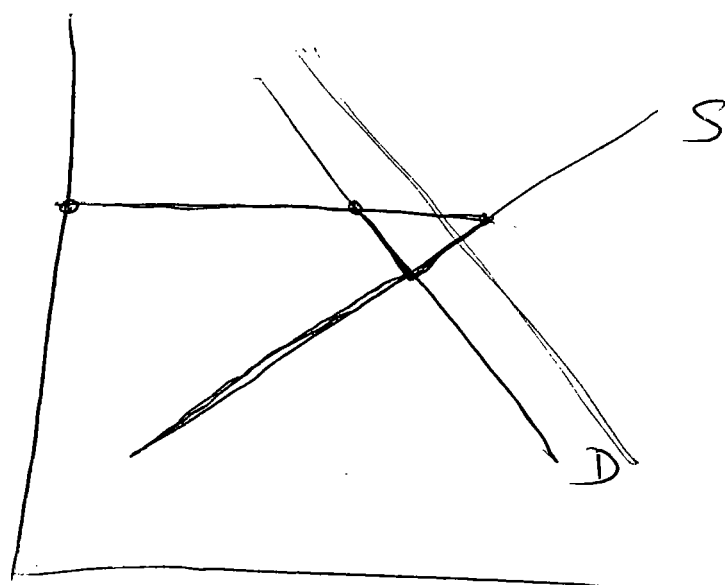
after by staffers who official description of league Dr. Zhang as a in 1994 and again this television aired horrors filmed covertly in phanages and similar where in the country. "Living Rooms," will air Jan. 24 at 8 p.m.

ains that both films man Rights Watch re-fabrications" by ene-d the Chinese people. believes that. The ther the international y more eager to get to it has been in the e first film appeared. closer Sino-U.S. ties, new report is a fly in e Clinton Administra-tion. Dr. Zhang a eble excuse that the in Hong Kong was her to seek safety in om the colony and, so he reach of her angry mainland.

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CENTER ON BUDGET AND POLICY PRIORITIES

To: Legislative Directors
From: Karen Lightfoot, Senior Legislative Associate
Subject: Minimum Wage Statement
Date: April 18, 1996

MEMORANDUM

As you know, the debate is intensifying over whether to raise the minimum wage. In this regard, I thought you might find of interest a statement supporting an increase in the wage that over 100 economists issued last October.

Among those signing the enclosed *Statement of Support for a Minimum Wage Increase* were three recipients of the Nobel Prize in Economics and seven past presidents of the American Economics Association.

If you have any questions, please contact me at 202-408-1080. Thank you.



CENTER ON BUDGET AND POLICY PRIORITIES

FOR IMMEDIATE RELEASE:
Monday, October 2, 1995, 9:30 a.m.

CONTACT: Michelle Bazie, (202) 408-1080
Nan Gibson (202) 775-8810

LEADING ECONOMISTS CALL FOR HIGHER MINIMUM WAGE

Three Nobel Winners Among 101 Signers of Statement Backing 90-Cent Hike Over Two Years

An eminent group of economists — including three recipients of the Nobel Prize in Economics — have endorsed an increase in the federal minimum wage in a statement released today.

Among the 101 signatories of the statement are seven past presidents of the American Economics Association and experts in disciplines ranging from labor markets and industrial relations to income distribution and poverty. Their statement was released by two Washington-based research organizations, the Center on Budget and Policy Priorities and the Economic Policy Institute.

The statement notes that "After adjusting for inflation, the value of the minimum wage is at its second-lowest annual level since 1955. The purchasing power of the minimum wage is 26 percent below its average level during the 1970s..." The purchasing power of the minimum wage reached its lowest level right before the last increase in 1990.

"We believe that the federal minimum wage can be increased by a moderate amount without significantly jeopardizing employment opportunities . . . Specifically, the proposed increase in the minimum wage of 90 cents over a two-year period falls within the range of alternatives where the overall effects on the labor market, affected workers and the economy would be positive," the economists' statement continues. (Such an increase has been proposed this year in both the Senate and the House of Representatives.)

The statement's release comes as Congress is actively considering reductions in the Earned Income Tax Credit. Workers who are affected by a stagnant minimum wage are in large part the same people who would be hurt by proposed EITC cuts.

Opponents of a higher minimum wage sometimes claim that economic opinion is settled against any increase. The statement shows that this claim is inaccurate; there is substantial support within the Economics profession for a moderate increase.

The three Nobel winners backing the minimum wage increase are Kenneth J. Arrow of Stanford, Lawrence R. Klein of the University of Pennsylvania, and James Tobin of Yale. Each has served as president of the American Economics Association. The other AEA past presidents signing the statement are Moses Abramovitz of Stanford, Robert Eisner of Northwestern, John Kenneth Galbraith of Harvard, and William Vickrey of Columbia.

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Statement of Support for a Minimum Wage Increase

As economists who are concerned about the erosion in the living standards of households dependent on the earnings of low-wage workers, we believe that the federal minimum wage should be increased. The reasons underlying this conclusion include:

- After adjusting for inflation, the value of the minimum wage is at its second lowest annual level since 1955. The purchasing power of the minimum wage is 26 percent below its average level during the 1970s.
- Since the early 1970s, the benefits of economic growth have been unevenly distributed among workers. Raising the minimum wage would help ameliorate this trend. The positive effects of the minimum wage are not felt solely by low-income households, but minimum wage workers are overrepresented in poor and moderate-income households.
- In setting the value of the minimum wage, it is of course appropriate to assess potential adverse effects. On balance, however, the evidence from recent economic studies of the effects of increases in federal and state minimum wages at the end of the 1980s and in the early 1990s -- as well as updates of the traditional time-series studies--suggests that the employment effects were negligible or small. Economic studies of the effects of the minimum wage on inflation suggest that a higher minimum wage would affect prices negligibly.
- Most policies to boost the incomes of low-wage workers have both positive and negative features. And excessive reliance on any one policy is likely to create distortions. The minimum wage is an important component of the set of policies to help low-wage workers. It has key advantages, including that it produces positive work incentives and is administratively simple. For these and other reasons, such as its exceptionally low value today, there should be greater reliance on the minimum wage to support the earnings of low-wage workers.

We believe that the federal minimum wage can be increased by a moderate amount without significantly jeopardizing employment opportunities. A minimum wage increase would provide a much-needed boost in the incomes of many low- and moderate-income households. Specifically, the proposed increase in the minimum wage of 90 cents over a two-year period falls within the range of alternatives where the overall effects on the labor market, affected workers, and the economy would be positive.

Signatories to Economists Statement of Support for a Minimum Wage Increase

Aaron, Henry — Brookings Institution
Abramovitz, Moses — Stanford University
Allen, Steven G. — North Carolina State University
Altonji, Joseph G. — Northwestern University
Appelbaum, Eileen — Economic Policy Institute
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Bator, Francis M. — Harvard University
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Burtless, Gary — Brookings Institution
Burton, John — Rutgers University
Chimerine, Lawrence — Economic Strategy Institute
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Darity, William Jr. — University of North Carolina
DeFreitas, Gregory — Hofstra University
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Faux, Jeff — Economic Policy Institute
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Gibbons, Robert — Stanford University
Glickman, Norman — Rutgers University
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Gordon, Robert J. — Northwestern University
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Gray, Wayne — Clark University
Harrison, Bennett — Harvard University
Hartmann, Heidi — Institute for Women's Policy Research
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Katz, Lawrence — Harvard University

Klein, Lawrence R. — University of Pennsylvania
Kleiner, Morris M. — University of Minnesota
Kochan, Thomas A. — Massachusetts Institute of Technology
Lang, Kevin — Boston University
Lester, Richard A. — Princeton University
Levy, Frank — Massachusetts Institute of Technology
Lindbloom, Charles E. — Yale University
Madden, Janice F. — University of Pennsylvania
Mangum, Garth — University of Utah
Margo, Robert — Vanderbilt University
Markusen, Ann — Rutgers University
Marshall, Ray — University of Texas at Austin
Medoff, James L. — Harvard University
Meyer, Bruce — Northwestern University
Minsky, Hyman P. — Bard College
Mishel, Lawrence — Economic Policy Institute
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Murnane, Richard J. — Harvard University
Musgrave, Peggy B. — University of California at Santa Cruz
Musgrave, Richard A. — University of California at Santa Cruz
Nichols, Donald — University of Wisconsin
Ooms, Van Doorn — Committee for Economic Development
Osterman, Paul — Massachusetts Institute of Technology
Packer, Arnold — Johns Hopkins University
Papadimitriou, Dimitri B. — Jerome Levy Economics Institute
Perry, George L. — Brookings Institution
Peterson, Wallace C. — University of Nebraska at Lincoln
Pfeifer, Karen — Smith College
Piore, Michael — Massachusetts Institute of Technology
Polenske, Karen — Massachusetts Institute of Technology
Quinn, Joseph — Boston College
Reich, Michael — University of California at Berkeley
Reynolds, Lloyd G. — Yale University
Scherer, F.M. — Harvard University
Schor, Juliet B. — Harvard University
Shaikh, Anwar — Jerome Levy Economics Institute
Smeeding, Tim — Center for Advanced Study in the Behavioral Sciences
Smolensky, Eugene — University of California at Berkeley
Stromsdorfer, Ernst W. — Washington State University
Summers, Anita A. — University of Pennsylvania
Summers, Robert — University of Pennsylvania
Tobin, James — Yale University
Vickrey, William — Columbia University
Voos, Paula B. — University of Wisconsin
Vroman, Wayne — Urban Institute
Watts, Harold — Columbia University
Whalen, Charles J. — Jerome Levy Economics Institute
Wolff, Edward — New York University



EXECUTIVE OFFICE OF THE PRESIDENT
COUNCIL OF ECONOMIC ADVISERS
WASHINGTON, D.C. 20500

April 22, 1996

SENIOR ECONOMIST

MEMORANDUM FOR JOSEPH STIGLITZ

MARTIN BAILY

ALICIA MUNNELL

PETER ORSZAG

LOUISE SHEINER

FROM

TOM KANE

SUBJECT

MINIMUM WAGE AND RELATED ISSUES

Senator Dole has mentioned two possible ways to make the minimum wage hike more palatable for the business community: a youth subminimum wage and some flexibility on the overtime provisions of the Fair Labor Standards Act. Below, I provide some background on each of these options.

1. Between 1990 and 1993, employers were allowed to pay a "subminimum wage" to youth aged 19 or under for up to 180 days. Little paperwork was required of employers seeking to take advantage of the subminimum for the first three months (90 days). To use the second 90 days of "subminimum wage" eligibility, an employer would be required to file a "training plan" with the Department of Labor. The "subminimum wage" provision expired in 1993 with little fanfare.

Very few employers have chosen to take advantage of the youth subminimum wage when it has been available in the past. For instance, Katz and Krueger found that only 4.8 percent of fast-food restaurants in Texas used the subminimum wage in 1991. Moreover, Katz and Krueger have also found that the introduction of the youth subminimum in 1990 had no discernible effect on the wages of youth.

Therefore, particularly if passed as a time-limited measure, a youth subminimum wage would not seriously weaken the effect of a minimum wage increase.

2. The Fair Labor Standards Act requires that employers pay overtime wages (1.5 times regular hourly pay) to covered workers working more than 40 hours in a given week. The largest exemptions are listed below:

- o Executive, administrative and professional employees.
- o Employees of seasonal amusement or recreational establishments.
- o Agricultural workers on small farms.
- o Persons employed as companions to the elderly or infirm.
- o Most employees of air carriers, trucking companies, taxi services and shipping companies.

The May 1985 CPS contained a supplemental question to identify workers receiving overtime pay. Roughly 10 percent of all employees received overtime pay during the survey week

in May 1985. Nearly half of those receiving overtime pay were in construction, manufacturing and mining (even though only about a quarter of all wage and salary workers worked in those industries).

The purpose of the original overtime-pay provision in the Fair Labor Standards Act of 1938 was to encourage employers to hire additional workers rather than make use of overtime. Indeed, the *Economic Report of the President* in 1964 advocated raising the overtime pay requirement from "time and one-half" to "double-time" to raise employment.

However, the expected impact of overtime pay restrictions on wages and hours is not clear. If employers and employees bargain over a *package* of compensation for an expected number of hours, it is unclear that such restrictions *would* have any effect on "effective" wages or employment. Employers and employees could simply agree on a straight-time wage and overtime pay that yielded a desired average wage-- and the right incentives for employers to smooth out the work. A recent paper by Trejo (attached) reported that straight-time wages were lower for covered workers working overtime than for workers with similar characteristics and similar hours who were not covered. Only those workers with a straight-time wage equal to the minimum wage would be constrained in making such a bargain with their employers. Trejo also found that covered workers with a straight-time wage equal to the minimum wage were less likely to be paid overtime when they worked more than 40 hours.

Therefore, in industries and occupations that are known to have fluctuating hours, we might expect the overtime pay provisions to have little effect since straight-time wages could adjust downward. However, such restrictions may have a larger impact when an employer has an atypical "spike" in demand, requiring employers to bear the cost of unanticipated inconveniences for workers. This may explain the fact that Trejo finds that only about half of the additional cost of overtime pay is offset by lowered straight-time wages.

A proposal has been floated to loosen the straight-time limit from 40 hours in a single week to 160 hours in 4 weeks. My initial reaction is that I do not believe that such a change would have a dramatic effect on overtime pay or employment for the following reasons.

First, given the Trejo results, the 40 hour limit may not be binding for many employer-employee bargains.

Second, a vast majority of those who ever work *more than* 40 hours in a week, *usually* work 40 hours per week, not less than 40. (In the 1993 CPS, 92 percent of those who reported working more than 40 hours in the previous week *usually* worked 40 hours or more.) In other words, an employer who wanted to avoid paying overtime would have to reduce an employee's work hours in subsequent weeks.

However, the politics of the proposal are likely to be complicated. Representatives of organized labor-- whose members probably benefit little from the minimum wage hike itself-- would probably resist any loosening of the overtime pay requirements. Such a proposal could drive a wedge into the coalition supporting the minimum wage.

cc: mJ

The Effects of Overtime Pay Regulation on Worker Compensation

By STEPHEN J. TREJO*

Proponents claim that a statutory overtime premium, by raising the relative cost of overtime, may encourage firms to substitute employment for overtime hours. I argue that there will be no real effects if firms reduce straight-time wages so as to offer the same package of weekly compensation and hours of work that was acceptable initially. Empirical analysis suggests that wage differentials do arise to mitigate the purely demand-driven effects predicted by previous models, but these differentials are not large enough to neutralize overtime pay regulation completely. (JEL J33, J38).

The Fair Labor Standards Act of 1938 (FLSA) introduced two forms of federal wage regulation into the U.S. labor market: a minimum wage and a requirement that an overtime wage of at least one and one-half times the straight-time hourly wage be paid for weekly hours worked in excess of 40. In contrast to the flood of research examining minimum wages, very little academic attention has been paid to the overtime pay provisions of the FLSA.¹ Such neglect is surprising because the overtime pay provisions potentially affect many more workers than the minimum-wage provisions: about a quarter of all employees work overtime during a typical week (Daniel E. Taylor and Edward S. Sekscenski, 1982), whereas only 11 percent of hourly paid workers earn the minimum wage or below (Earl F. Mellor and Steven E. Haugen, 1986). This paper

investigates the economic consequences of overtime pay regulation.

This project acquires added urgency and policy significance from periodic proposals before Congress to increase the required overtime wage to twice the straight-time hourly wage.² Proponents argue that such a measure would induce firms to cut back on overtime hours assigned and instead hire more workers to take up the slack; thus, a kind of economy-wide work-sharing would ensue to reduce unemployment. Neoclassical labor-demand theory, appropriately adapted to treat this problem, lends some support to such a claim. If straight-time wages rates are taken as fixed, increasing the overtime premium reduces the cost of expanding output by hiring another worker relative to the cost of expanding output by employing the current work force for an additional hour, so firms are encouraged to substitute employment for overtime hours. Of course, increases in the overtime premium also raise the marginal cost of production, thereby generating an opposing scale effect, which leaves the net effect on employment theoretically indeterminate. Within this framework, the social cost of overtime pay regulation is the usual distortion introduced by any tax on a factor of production.

*Department of Economics, University of California, Santa Barbara, CA 93106. For advice and comments, I am grateful to Gary Becker, George Borjas, Steve Bronars, Donald Deere, Ron Ehrenberg, Ted Frech, Dan Hamermesh, Robert Hart, Ed Lazear, Tom Mroz, Kevin Murphy, Sherwin Rosen, Perry Shapiro, Bob Topel, two referees, and participants in various seminars.

¹For an introduction to the vast literature on the effects of minimum wages, see the survey by Charles Brown et al. (1982). Previous inquiries into the effects of overtime pay regulation have been conducted by Ronald G. Ehrenberg (1971), Joyce E. Nussbaum and Donald E. Wise (1977), and Ehrenberg and Paul L. Schumann (1982b).

²An example of such a proposal is HR 2933 introduced in 1985 by Representative John Conyers of Michigan.

An alternative view of the labor market predicts that the overtime pay provisions of the FLSA will have little effect on real economic behavior. Following the ideas of H. Gregg Lewis (1969), a job is simply a tied package of compensation and working conditions. A job that usually requires a fixed number of hours of work per week must provide workers with enough compensation to make them at least as well off as any other job package they could obtain. According to this view, increasing the statutory overtime premium will have no real effects since, by reducing the straight-time hourly wage rate, the firm can offer the same package of total weekly compensation and hours of work that was acceptable to the worker initially. For example, suppose that in the absence of overtime pay regulation a job pays \$550 per week and requires 50 hours of work, so the average wage is \$11 per hour. An employer may satisfy the FLSA by reducing the straight-time wage to \$10 per hour and paying time and a half for the 10 overtime hours. The employee works 50 hours and receives \$550 per week in either case; consequently, the law has no real effect. Moreover, overtime pay regulation leaves total employment unaffected and imposes no social costs. In this alternative view of the labor market, overtime pay regulation only affects those workers with straight-time wage rates that cannot be fully adjusted, such as those of workers earning the legal minimum wage.

The next two sections present these alternative approaches to modeling the consequences of overtime pay regulation. The approach taken by previous studies, which I will call the "fixed-wage" approach to overtime pay regulation, attributes real economic effects to the overtime law and in particular predicts that raising the statutory overtime premium should reduce the use of overtime hours and increase the prevalence of a 40-hour work week. An alternative approach is developed, a "fixed-job" model, which suggests that hourly wage flexibility may be sufficient to rob overtime pay regulation of any substantive impact. The fixed-wage and fixed-job models are theories of overtime pay *regulation*, rather than

of overtime pay *provision*, in that these models attempt to describe the labor-market effects which would result from the exogenous imposition of an overtime premium. Without further assumptions about worker preferences, they have nothing to say about why firms would voluntarily pay an overtime premium in the absence of regulation, or why in the presence of regulation firms would adopt an overtime pay schedule more generous than that required by law.³

The remainder of the paper attempts to determine whether the fixed-job model is of any empirical importance. My strategy is to compare workers covered by the overtime law with noncovered workers using microdata from the 1974, 1976, and 1978 May Current Population Surveys. Section III describes the data and discusses the classification of workers according to coverage status under the minimum-wage and overtime pay provisions of the FLSA. Section IV examines compliance with the overtime law, under the presumption that incentives to disregard the law should be greatest for those employers most adversely affected by the law. Section V searches for differences in distributions of weekly hours of work that are attributable to overtime pay coverage. Section VI compares the hourly wages and weekly earnings of covered and noncovered workers to investigate the extent to which adjustments occur to offset the statutory overtime premium. I test not only for the existence of straight-time wage differentials between the covered and noncovered sectors, but also whether these differentials are sufficiently large to neutralize overtime pay regulation completely. A final section summarizes and concludes.

I. The Fixed-Wage Model of Overtime Pay Regulation

Ehrenberg (1971) adapts the framework found in Rosen (1968) to illustrate the sub-

³Worker preferences may require that jobs with different hours schedules offer different wage schedules, as set out in the compensating-differential models of Lewis (1969), Sherwin Rosen (1974), and John M. Abowd and Orley Ashenfelter (1981).

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stitution of employment for overtime hours induced by an increase in the statutory overtime premium. Capital is assumed to be fixed, and the firm faces an exogenous output requirement to be met by choosing the number of employees and weekly hours worked by each employee. The production technology allows the marginal product of an additional man-hour of work to differ depending on whether it is obtained by expanding employment or through increased utilization of the existing force. With the straight-time hourly wage rate taken as fixed, an increase in the overtime premium raises the marginal cost of overtime hours relative to the marginal cost of hiring an additional worker. Cost-minimizing firms respond by expanding employment and cutting back on overtime hours.⁴

One other potential consequence of overtime pay regulation is readily apparent. If the straight-time wage is exogenous, then the overtime pay structure imposed by the FLSA creates a kink in the firm's cost function at the statutory work week standard of 40 hours. It is easy to show that this kink induces some firms that would assign overtime in the absence of overtime pay regulation to choose instead the corner solution in which they avoid paying the overtime premium by limiting weekly hours of work to 40. Thus, the fixed-wage model of overtime pay regulation provides one possible explanation for the well-known fact that the hours-of-work distribution has a spike at 40 hours. This issue is investigated in the empirical work reported below.

Existing tests of the fixed-wage model have focused on the prediction that an overtime premium should discourage the use of overtime hours. Ehrenberg and Schumann

(1982b) provide the most recent estimates and also review previous work. All studies use establishment-level data from various years of the Employer Expenditure for Employee Compensation surveys. The basic empirical methodology is to regress annual overtime hours per employee on control variables and the ratio of quasi-fixed labor costs to the overtime wage. Typical findings indicate a statistically significant positive association across establishments between this ratio and the use of overtime. However, Ehrenberg and Schumann (1982b) show that this result is driven by the strong correlation between quasi-fixed labor costs and overtime hours: when quasi-fixed labor costs and the overtime wage enter the regressions separately rather than in ratio form, the coefficients on the overtime wage often have the wrong sign and tend to be statistically insignificant. Moreover, virtually all firms are covered by the FLSA within most of the industries on which these regressions are run, so there is very little variation in the overtime premium with which to estimate directly the impact of overtime pay regulation. For these reasons, existing empirical analyses of the overtime-hours response generated by a statutory overtime premium are inconclusive.

II. A Fixed-Job Model

The fixed-wage model described above lends theoretical support to the idea that raising the overtime premium required by the FLSA would reduce overtime hours and possibly stimulate employment. However, this model assumes that the supply of hours is infinitely elastic at the given market wage rate and that this market wage is unaffected by overtime pay regulation. As suggested by Lewis (1969), the length of the work week can be viewed as a job aspect over which both firms and workers have preferences, with compensating wage differentials arising in equilibrium for jobs with differing hours of work. Under this alternative characterization of the labor market, differentials in straight-time hourly wages could arise to render overtime pay regulation almost completely inconsequential.

⁴This analysis ignores scale effects. With output endogenous, raising the overtime premium will reduce overtime hours so long as the scale effect is non-perverse, but the net impact on employment is indeterminate because of conflicting substitution and scale effects (Nussbaum and Wise, 1977). Similar remarks apply when capital is variable, because increasing the overtime premium encourages substitution out of labor inputs and into capital.

The basic idea is simple. A job consists of a given package of weekly hours of work and weekly earnings. The FLSA requires that weekly hours worked in excess of 40 be compensated at a rate of at least one and one-half times the straight-time hourly wage, but the act does not regulate the straight-time hourly wage except to require that it not fall below the legal minimum wage. So long as *hourly* wage rates are flexible, the overtime law does not in any way restrict the ability of workers and firms to contract over packages of *weekly* hours and earnings. Changes in the overtime premium or work-week standard set by law would produce perfectly offsetting changes in straight-time hourly wage rates so as to leave weekly hours and earnings unchanged.⁵

To see this point, consider the situation in which overtime pay regulation is in place and overtime hours are being worked. In this case, a worker's weekly earnings Y can be expressed as

$$(1) \quad Y = w[\bar{H} + b(H - \bar{H})]$$

where H represents weekly hours of work, w is the straight-time hourly wage rate, b denotes the overtime premium required by law, and $\bar{H}$ is the weekly-hours standard at which the overtime premium must go into effect (the FLSA currently requires $b \geq 1.5$ and $\bar{H} \leq 40$). Holding hours of work constant, the firm is indifferent between any combinations of straight-time and overtime wage rates that produce the same level of weekly earnings. Exactly the same kind of indifference will hold for standard formulations of worker preferences, in which an individual's utility is a function of income

for consumption and hours of work. That is, workers care only about how much weekly compensation they receive for a given amount of effort, and it does not matter to them how this compensation is split between straight-time pay and overtime pay. Suppose that in the absence of the FLSA a given employee works $H_0 > 40$ hours and is paid w_0 for each hour. When the FLSA is introduced, a straight-time wage of $w' = w_0 H_0 / (1.5 H_0 - 20)$ leaves the worker at precisely the same level of welfare as he was initially.

Under these circumstances, the firm and its workers may be expected to come to an agreement regarding the quantities that they jointly care about: weekly earnings and weekly hours. Regardless of exactly how this earnings-hours package is determined, equation (1) reveals that flexibility of the straight-time hourly wage is sufficient to neutralize overtime pay regulation. Whatever levels initially chosen for Y and H , w can adjust to legislative changes in b and $\bar{H}$ so as to maintain these initial levels. This extra degree of freedom allows weekly hours, weekly earnings, and employment to be unaffected by overtime pay regulation. Because in this model it is the job package of weekly hours and earnings (rather than the straight-time wage) that remains fixed, I refer to this as the fixed-job model of overtime pay regulation.

The preceding analysis has been entirely of a static nature, focusing on the determination of regularly scheduled overtime. It might well be objected that much of overtime is due to stochastic events such as unexpected demand, machine breakdowns, and absenteeism and that a dynamic model is necessary to capture these factors adequately. The simple fixed-job model developed above requires perfect wage flexibility to justify its strong conclusion that overtime pay regulation fails to have any real economic impact. This result will obviously be robust to dynamic specifications, provided that the straight-time hourly wage rate is flexible *in each period*. However, to the extent that variability in hours of work is not always accompanied by changes in the straight-time wage, the adjustment mecha-

⁵The seeds of this idea can be traced back as far as Paul H. Douglas and Joseph Hackman (1939 pp. 34-5). In addition, Ehrenberg and Schumann (1982b pp. 36-8) recognize that straight-time wage differentials could arise to offset the statutory overtime premium, but they do not argue that these wage differentials would necessarily be perfectly offsetting. They also suggest that compensating adjustments in fringe benefits could occur, which would accentuate the effects of the overtime premium.

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nism specified in the simple fixed-job model must be at best incomplete.

These issues led me to consider an extended version of the fixed-job model in which firms are allowed to vary the work week after observing the state of demand but in which employment and the straight-time wage must be chosen *ex ante*. Within the context of this extended model, increases in the statutory overtime premium can produce nonzero effects on hours and employment, but the direction of these effects is theoretically indeterminate. Moreover, if workers can borrow and save to transfer earnings across states of nature, the neutrality result of the simple static fixed-job model will tend to hold even in this more complicated setting. Intuitively, the ability to borrow and save means that workers do not care about the variance in weekly earnings so long as the discounted value of their total pay equals the correct level over a longer time period, such as the year.

From a policy perspective, it may be desirable to focus on regularly scheduled overtime, since these are the hours of overtime that are easiest to convert into new jobs. In addition, static versions of the fixed-wage and fixed-job models yield sharper empirical implications. Therefore, the empirical tests conducted below concentrate on the "usual" work week and assume that a large fraction of overtime persists from week to week. The U.S. Department of Labor (1985) publishes hours data that can shed some light on the appropriateness of this assumption. Average weekly overtime hours of production workers are available on a monthly basis for manufacturing industries. For the period 1974-1978, which includes the years to be analyzed, overtime per worker averaged 3.2 hours per week for all of manufacturing. Over these 60 monthly observations, average weekly overtime ranged from a low of 2.2 hours to a high of 3.9 hours, with a standard deviation of 0.4 hours. Overtime variability is similar within more disaggregated manufacturing industries with two-, three-, and four-digit SIC codes. Thus, these numbers are consistent with the notion that a large part of overtime is regularly scheduled, but it must be cautioned that they are

averages which mask variation across workers within a firm and across firms within an industry.

III. Data

The data analyzed below come from the 1974, 1976, and 1978 May Current Population Surveys (CPS).⁶ These May versions of the CPS are especially useful for the present study because they contain information on whether or not individuals receive an overtime premium for weekly hours of work in excess of 40, in addition to data on straight-time hourly wages, weekly earnings and hours, and demographic characteristics. This section describes general features of these data, especially with regard to the classification of workers according to coverage status under the minimum-wage and overtime pay provisions of the FLSA.

The empirical analysis requires knowledge of whether or not a given worker falls under the jurisdiction of the overtime pay provisions of the FLSA. I first exclude unemployed or self-employed individuals and multiple jobholders and then classify remaining individuals into three groups: those believed to be subject to the overtime pay provisions of the FLSA (covered workers), those believed not to be subject (non-covered workers), and those workers whose coverage status could not be ascertained from the information available in the May CPS. This final group is excluded from the analysis. The detailed industry and occupation classifications provided in the CPS were coded to determine the coverage status of each individual.⁷ This method of assigning

⁶These years were chosen for study because hourly-wage questions were not asked in the CPS until 1973, and beginning in 1979 these questions were only asked of a quarter of the sample. Also, the CPS sampling scheme is such that May surveys in adjacent years have about half of their households in common.

⁷Details of the coding algorithm used to assign coverage status to each individual are available from the author. The algorithm does not consider independent state regulations that supplement the FLSA, but little is lost by this omission. Very few states regulate overtime, and state minimum wages seldom exceed the

coverage under the FLSA has been used previously by Ashenfelter and Robert S. Smith (1979 p. 341) and Brigitte H. Sellekaerts and Stephen W. Welch (1981 tables 3 and 4) for the minimum-wage provisions, and by Ehrenberg and Schumann (1982b appendix C) for the overtime pay provisions. Other sources found helpful in interpreting the FLSA and its many exemptions were U.S. Congress (1974) and Conrad. F. Fritsch (1981).

The largest group of exempt employees comprises executive, administrative, and professional workers. To qualify for this exemption the employee must be paid on a salary basis. Since the covered sector does not include a comparable group of workers, individuals employed in these types of occupations are excluded from the analysis. As a further safeguard against misclassifying these exempt supervisory employees, I restrict the sample to those individuals who report being paid by the hour. Outside sales-workers and employees paid on a commission basis are also exempt under the law, necessitating the exclusion of virtually all sales-workers because the coverage status of these individuals could not be determined. Most employees in retail trade and many in service industries have their coverage status determined by the size of their employer. Because this information is not available for the years of the CPS I analyze, these individuals are also excluded unless they are exempt for other reasons.

Workers classified as definitely *not* subject to the overtime pay provisions of the FLSA include essentially all nonsupervisory agricultural workers, as well as employees in the transportation sector who fall under the jurisdiction of other federal statutes such as the Motor Carriers Act of 1935, the Interstate Commerce Act, and the Railway Labor Act.⁸ Remaining noncovered workers in

federal minimum and generally only apply to those workers already excluded from the current sample because their coverage status could not be determined. See Aline O. Quester (1981) for a discussion of state minimum-wage laws.

⁸None of these other federal statutes requires payment of an overtime premium, although they do some-

my data come from miscellaneous exemptions that apply to certain workers in retail trade, services, and state and local government. Virtually all nonsupervisory employees in mining, construction, and manufacturing are subject to the overtime pay provisions of the FLSA, as are federal government workers not exempt for other reasons.

The 1974 and 1977 amendments to the FLSA require that the rules used for assigning coverage status be slightly different in each of the three years studied. The most important differences concern the coverage status of state and local government employees. The 1974 amendments attempted to bring all public employees under the jurisdiction of the act, but the constitutionality of this extension was quickly challenged, and in June 1976 the Supreme Court ruled unenforceable all minimum-wage and overtime pay provisions of the FLSA as they apply to state and local public employees engaged in traditional governmental functions.⁹ Therefore, most state and local government employees are classified as covered in 1974 and 1976 but noncovered in 1978.¹⁰ Employees in police and fire protection constitute an exception to this statement, since these workers never were subject to the overtime pay provisions of the FLSA.

The empirical analysis also requires identifications of those individuals covered by

times restrict hours of work. For example, certain truck drivers are prohibited from working more than 70 hours in any period of eight consecutive days.

⁹This ruling was made in *National League of Cities v. Usery*, 426 U.S. 833. With its decision in *Garcia v. San Antonio Metropolitan Transit Authority et al.*, 105 S.Ct. 1005 (February 1985), the Supreme Court recently overruled its earlier decision and upheld the constitutionality of applying the FLSA to state and local government employees, but this ruling occurred well after the time period being studied.

¹⁰Except for the analysis of hours-of-work distributions to be discussed in Section V, none of the empirical results reported here is sensitive to the coverage status of state and local government employees. Similar results are obtained when these workers are excluded from the sample or if it is assumed that, because of the confusion surrounding the ensuing litigation, state and local governments never acted as if they were subject to the FLSA during the time period under study.

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TABLE 1—VARIABLE DEFINITIONS

Variable	Definition
OTPAY	1 if received premium pay for weekly hours worked over 40; 0 otherwise
HOURS40	1 if worked exactly 40 hours during survey week; 0 otherwise
WAGE	straight-time hourly wage rate in dollars
EARNINGS	usual weekly earnings in dollars
HOURS	usual weekly hours of work
OTCOVER	1 if subject to the overtime pay provisions of the FLSA; 0 otherwise
MINWAGE	1 if subject to and earning the legal minimum wage; 0 otherwise
OTCOVG40	1 if OTCOVER = 1 and HOURS > 40; 0 otherwise
UNION	1 if member of labor union or employee association; 0 otherwise
AGE	years of age
EDUC	completed years of schooling
MARRIED	1 if married, spouse present; 0 otherwise
FEMALE	1 if female; 0 otherwise
BLACK	1 if black; 0 otherwise
NONWHITE	1 if nonwhite other than black; 0 otherwise
CITY	1 if reside in central city of SMSA; 0 otherwise
SUBURB	1 if reside in SMSA, but not in central city; 0 otherwise
GOVTEMP	1 if government employee; 0 otherwise

and earning the legal minimum wage. Since exemptions to the minimum-wage law constitute a subset of the overtime exemptions, it turns out that coverage under the minimum-wage law includes all those covered by the overtime law and some additional workers as well. In 1978, a single minimum wage of \$2.65 per hour applied to all covered workers, so in this year determining which are minimum-wage workers is straightforward. In 1974 and 1976, however, separate minimum wages applied to agricultural workers, workers covered prior to the 1966 amendments, and workers newly covered by the 1966 and 1974 amendments. Workers in these years are first assigned to the proper minimum-wage category,¹¹ and then minimum-wage status is determined by comparing the individual's actual wage with the appropriate minimum wage. Minimum-wage rates in 1974 were \$1.60 per hour for agricultural workers, \$1.90 per hour for newly covered workers, and \$2.00 per hour for

workers covered prior to 1966. These same minimum-wage rates in 1976 were \$2.00, \$2.20, and \$2.30 per hour, respectively.

Table 1 defines the main variables used in the empirical analysis. To give an idea how the covered and noncovered sectors differ, Table 2 presents means and standard deviations by status of overtime pay coverage for the May 1978 CPS sample employed in the earnings regressions reported below.¹² The data for 1974 and 1976 are similar except that, because of the change in coverage status for state and local government employees, overall coverage rates rise to just over 90 percent of the sample, and the

¹²Not all workers in the 1970 Census major occupation classifications "professional, technical, and kindred workers" and "managers and administrators, except farm" qualify for the FLSA exemption, which applies to executive, administrative, and professional employees (Sellekaerts and Welch, 1981 table 3). This is why the major occupation categories "professional" and "administrative" have nonzero means in Table 2. Examples of professional and administrative occupations that do not qualify for this exemption include computer programmers, technicians, surveyors, and railroad conductors.

¹¹Once again, by using the industry and occupation classifications provided in the CPS.

TABLE 2—DESCRIPTIVE STATISTICS, 1978 EARNINGS SAMPLE

Variable	All		Covered		Noncovered	
	Mean	SD	Mean	SD	Mean	SD
EARNINGS	263.372	109.941	267.439	108.354	239.869	115.985
WAGE	6.209	2.348	6.294	2.321	5.710	2.443
OTCOVER	0.853	0.355	1.000	0.000	0.000	0.000
OTCOVG40	0.198	0.398	0.232	0.422	0.000	0.000
HOURS	41.888	6.291	41.947	5.984	41.552	7.828
AGE	35.276	12.693	35.274	12.594	35.290	13.258
EDUC	11.300	2.407	11.298	2.372	11.311	2.602
UNION	0.494	0.500	0.499	0.500	0.462	0.499
MARRIED	0.732	0.443	0.741	0.438	0.677	0.468
CITY	0.185	0.388	0.183	0.386	0.197	0.398
SURBURB	0.356	0.479	0.359	0.480	0.334	0.472
GOVTEMP	0.094	0.292	0.043	0.202	0.388	0.488
Major industry:						
Agriculture	0.022	0.146	0.006	0.075	0.114	0.318
Mining	0.034	0.182	0.040	0.196	0.000	0.000
Construction	0.178	0.382	0.208	0.406	0.001	0.030
Durable manufacturing	0.310	0.463	0.363	0.481	0.002	0.042
Nondurable manufacturing	0.146	0.353	0.171	0.376	0.000	0.000
Transportation and utilities	0.125	0.331	0.071	0.256	0.440	0.497
Wholesale trade	0.039	0.194	0.046	0.209	0.000	0.000
Retail trade	0.013	0.115	0.000	0.000	0.090	0.287
Finance, insurance, and real estate	0.009	0.097	0.11	0.105	0.000	0.000
Services	0.124	0.329	0.084	0.278	0.353	0.478
Major occupation:						
Professional	0.035	0.185	0.036	0.187	0.029	0.169
Administrative	0.001	0.034	0.000	0.000	0.008	0.089
Sales	0.001	0.030	0.000	0.000	0.006	0.079
Clerical	0.072	0.259	0.070	0.254	0.088	0.284
Crafts	0.386	0.487	0.410	0.492	0.251	0.434
Operatives	0.321	0.467	0.342	0.475	0.197	0.398
Laborers	0.110	0.313	0.106	0.308	0.131	0.338
Service workers	0.059	0.235	0.035	0.185	0.194	0.395
Farm workers	0.014	0.117	0.000	0.000	0.095	0.293
Sample size:	7,594		6,474		1,120	

Notes: The sample consists of white males aged 18–64 who usually work at least 20 hours per week and for whom coverage status could be determined. Because of missing values, the sample sizes for the WAGE variables are as follows: 7,222 for the full sample, with 6,166 in the covered sector and 1,056 in the noncovered sector.

fraction of noncovered workers who are government employees falls substantially.

IV. Overtime Pay Compliance

If the FLSA imposes real costs upon firms, some employers may choose to disregard the law. Incentives for noncompliance should vary directly with the cost of conforming to the law, so that investigating

compliance with the FLSA can provide some information on whether the act imposes binding constraints upon firms. Actual monetary sanctions against first-time offenders of the FLSA are almost invariably substantially less than the amount of underpayment, and due to a limited enforcement budget the probability of detection is probably quite low, so it is not surprising that previous studies have uncovered significant

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amounts of noncompliance with both the minimum-wage and overtime pay provisions of the FLSA.¹³ This section reexamines compliance with the overtime law in order to test a prediction of the fixed-job model.

The fixed-job model implies that overtime pay compliance should be lower for minimum-wage workers than for other workers. Incentives for noncompliance should be strongest in those sectors where the law has real economic effects, and the fixed-job model suggests that overtime pay regulation only affects those workers with straight-time hourly wage rates that cannot be fully adjusted to offset the law. This type of wage rigidity exists among workers covered by and earning the legal minimum wage. If this is the sole source of wage rigidity, then the fixed-job model implies that noncompliance should occur only with minimum-wage workers. For all other workers, adjustment of straight-time hourly wages provides a virtually costless means of complying with the overtime law, so employers of these workers would never risk having to pay a penalty for noncompliance. As a practical matter, however, ignorance and misinterpretation of coverage status under the law provide reasons for less than perfect compliance among workers earning more than the minimum wage. Furthermore, in the empirical work, it is inevitable that some workers have been mistakenly classified as being covered by overtime pay regulation, and there may also exist reporting error by CPS respondents as to their receipt of premium pay for overtime. For these reasons, the hypothesis to be tested is whether the overtime pay compliance rate among minimum-wage workers is significantly lower than that among other workers. Note that the fixed-wage model provides no justification for such a disconti-

nuity in the relationship between overtime pay compliance and hourly wage rates.

The May CPS data described above provide the necessary information for examining the correlation between minimum-wage status and compliance with the overtime pay provisions of the FLSA. These surveys ask those individuals who worked more than 40 hours during the survey week for a single employer whether or not they received a higher rate of pay for weekly hours of work above 40. Table 3 reports, for covered workers who put in overtime during the survey week, the percentage of these workers in various wage intervals who received premium pay for overtime in compliance with the FLSA.¹⁴

¹⁴The minimum wage is assumed to be binding for those workers covered by the minimum-wage law who earn exactly the minimum wage. If the legal minimum wage coincidentally happens to be the equilibrium wage for some workers, so that the minimum wage is not binding for these minimum-wage workers, then the results reported in Table 3 are biased against the prediction of the fixed-job model. Note also that the numbers in Table 3 imply that some employers choose to comply with the minimum-wage provisions of the FLSA while at the same time violating the overtime pay provisions. Because the Wage and Hour Division of the Employment Standards Administration in the Department of Labor enforces both sets of provisions and therefore any inspection by enforcement agents is likely to uncover all violations of the FLSA, it might seem that rational employer behavior would dictate a package decision either to comply fully with the FLSA or else violate both sets of provisions simultaneously. However, most inspections are precipitated by employee complaints to the Wage and Hour Division (Ashenfelter and Smith, 1979), so employers might find it optimal to comply with one set of provisions and not the other if the provisions differ in the likelihood that noncompliance would induce an employee complaint. The overtime pay provisions are much less publicized and contain more numerous and complicated exemptions than the minimum-wage provisions, and these factors could result in employees being less likely to recognize and report employer noncompliance with overtime pay regulation.

Table 3 excludes the fewer than 15 workers in each year who earn less than the minimum wage. Although minimum-wage noncompliance is much larger than this (Ashenfelter and Smith, 1979), the subsample considered here misses many subminimum-wage workers because overtime pay data is only available for those who worked overtime during the survey week and also because subminimum-wage workers are often employed in industries that could not be classified as definitely subject to the overtime pay provisions of the FLSA.

¹³See Ashenfelter and Smith (1979) and Sellekaerts and Welch (1983, 1984) for evidence on noncompliance with the minimum wage and for discussions of the penalty and enforcement mechanisms that have been established to discourage noncompliance. Ehrenberg and Schumann (1982a) and Sellekaerts and Welch (1983) provide similar information concerning the overtime pay provisions.

TABLE 3—RATES OF OVERTIME PAY COMPLIANCE FOR COVERED WORKERS

Hourly wage	1974		1976		1978	
	Percentage compliance	Sample size	Percentage compliance	Sample size	Percentage compliance	Sample size
Minimum wage	67.2	58	77.4	53	66.0	53
Minimum wage-\$3.00	82.3	541	81.4	338	85.0	180
\$3.01-\$4.00	93.4	683	88.7	558	87.5	528
\$4.01-\$5.00	94.5	598	90.4	510	92.1	520
\$5.01-\$6.00	95.2	395	93.7	396	92.0	427
\$6.01-\$7.00	93.1	131	94.5	290	93.4	422
\$7.01 and above	91.7	84	89.1	221	92.8	755
All covered workers	90.8	2,490	89.3	2,366	91.0	2,885

Notes: The samples consist of covered employees who worked more than 40 hours during the survey week. The basic minimum hourly wages in the three years were \$2.00 in 1974, \$2.30 in 1976, and \$2.65 in 1978.

The overall compliance rates of around 90 percent are very similar to what Ehrenberg and Schumann (1982a) report for the May 1978 CPS data. In all three years, rates of overtime pay compliance plunge for minimum-wage workers, even relative to the compliance rates of those workers earning just above the minimum wage, although the decline in 1976 is not as drastic as in the other years. In all three years, chi-square homogeneity tests performed on the cell frequencies overwhelmingly reject the hypothesis of identical compliance rates for minimum-wage and nonminimum-wage workers. Therefore, these compliance statistics provide strong support for the fixed-job model. However, the simple proportions presented in Table 3 do not control for other factors that might affect compliance with overtime pay regulation, and Ehrenberg and Schumann (1982a) have shown some of these other factors to be significantly correlated with compliance. Furthermore, it appears from the table that wage rates could be correlated with compliance, and it remains to be demonstrated that minimum-wage status has an effect on compliance separate from that of having a low wage.

To meet these objections, Table 4 presents compliance logits similar to the non-compliance probits reported by Ehrenberg and Schumann (1982a) for the May 1978 CPS data, except that I add a dummy variable identifying minimum-wage workers and

replicate the analysis for the May 1974 and 1976 CPS data as well. The sample again consists of covered employees who worked more than 40 hours during the survey week, and the dependent variable is a dummy indicating whether or not the individual received premium pay for overtime.¹⁵ The independent variables include the minimum-wage dummy of primary interest, a vector of socioeconomic characteristics of the individual, a set of dummies indicating major industry and major occupation, and a set of dummies indicating the census geographic division in which the worker resides. The industry, occupation, and geographic dummies are included to control for the possibility that government efforts to enforce the FLSA vary in intensity across sectors. The coefficients of these dummy variables are not reported. Standard errors are given in parentheses, and derivatives of the compliance probability with respect to the independent variables are also reported.

The results are consistent with the fixed-job model. The minimum-wage dummy has a negative coefficient in all three years, al-

¹⁵Table 4 includes the subminimum-wage workers excluded from Table 3, and this accounts for the slight differences in sample sizes across the tables. These subminimum-wage workers are classified as nonminimum-wage workers in the logits reported in Table 4, but the results do not change when these workers are excluded.

TABLE 4—LOGITS FOR OVERTIME PAY COMPLIANCE (DEPENDENT VARIABLE = OTPAY)

Variable	1974		1976		1978	
	Coefficient	Derivative	Coefficient	Derivative	Coefficient	Derivative
MINWAGE	-0.6944 (0.3380)	-0.0597	-0.2979 (0.4075)	-0.0286	-1.0549 (0.3545)	-0.0886
WAGE	0.3567 (0.0970)	0.0307	0.4010 (0.1434)	0.0385	0.3590 (0.1438)	0.0302
WAGE ² /100	-0.7379 (0.2467)	-0.0635	-2.5807 (1.0085)	-0.2477	-1.8054 (0.9733)	-0.1517
AGE	0.0148 (0.0066)	0.0013	-0.0050 (0.0061)	-0.0005	-0.0134 (0.0059)	-0.0011
EDUC	0.1060 (0.0332)	0.0091	0.0053 (0.0328)	0.0005	-0.0074 (0.0320)	-0.0006
UNION	0.5972 (0.2080)	0.0514	1.0742 (0.2125)	0.1031	0.8265 (0.1977)	0.0694
MARRIED	-0.1450 (0.1768)	-0.0125	0.0138 (0.1709)	0.0013	-0.0907 (0.1587)	-0.0076
FEMALE	-0.1042 (0.2224)	-0.0090	0.2487 (0.2172)	0.0239	0.0618 (0.2018)	0.0052
BLACK	-0.5305 (0.2689)	-0.0456	-0.5858 (0.2605)	-0.0562	-0.2307 (0.2542)	-0.0194
NONWHITE	-0.1487 (0.8622)	-0.0128	-0.1169 (0.6914)	-0.0112	0.3911 (0.7787)	0.0329
CITY	0.2874 (0.2053)	0.0247	-0.2074 (0.1997)	-0.0199	0.2299 (0.1972)	0.0193
SUBURB	0.0810 (0.1839)	0.0070	-0.1588 (0.1828)	-0.0152	0.1562 (0.1729)	0.0131
GOVTEMP	-0.3039 (0.2725)	-0.0261	0.1535 (0.2755)	0.0147	-0.5965 (0.3783)	-0.0501
Log likelihood:	-650.6		-683.7		-789.7	
Sample size:	2,504		2,379		2,895	

Notes: Standard errors are given in parentheses. The samples consist of covered employees who worked more than 40 hours during the survey week. Also included as independent variables were dummy variables indicating major industry, major occupation, and census geographic division. Derivatives of the compliance probability with respect to the independent variables were calculated using the overall compliance frequency of each sample: 0.905 in 1974, 0.892 in 1976, and 0.908 in 1978.

though this effect is not statistically significant in 1976.¹⁶ Furthermore, the estimated

¹⁶Reducing the straight-time wage to the minimum wage may not represent complete adjustment for some workers earning slightly above the minimum wage, so the fixed-job model implies that incentives for noncompliance also exist for these nonminimum-wage workers. Consistent with this, Table 3 reveals that compliance is relatively low for workers earning close to but above the minimum wage. However, this effect disappears in compliance logits that are identical to those reported in Table 4 except for the addition of a dummy variable identifying workers earning up to 25 cents above the basic minimum wage. In two of the three years, the coefficient on this dummy variable was not close to being statistically significant, and its inclusion did not affect the estimated coefficients of the minimum-wage dummy.

effects of this variable are relatively large, especially in 1974 and 1978. Within the covered sector, minimum-wage workers are associated with 3–9 percentage points lower probability of being paid an overtime premium, even after controlling for the wage and other characteristics of the worker.

However, Table 3 suggests that the relationship between overtime pay compliance and hourly wage rates may not be monotonic, so it could be objected that the minimum-wage dummy is simply picking up some of this nonlinearity rather than a true minimum-wage effect. It is for this reason that the wage is entered as a quadratic in the logits reported in Table 4, and the estimates do imply an inverted U-shaped relationship between compliance and wages, but even

with this specification the minimum-wage dummy has important effects. As an additional specification check of this type, logits were estimated including another dummy variable identifying workers earning the arbitrarily chosen wage of \$3.00 per hour. The \$3.00-per-hour wage dummy was found to be statistically insignificant, and its inclusion did not change the coefficients of the minimum-wage dummy, indicating that the estimated minimum-wage effect is unlikely to be an artifact arising entirely from misspecification or from the similarity between minimum-wage workers and other low-wage workers.¹⁷

Another possibility is that the minimum-wage dummy captures nothing more than a firm-size effect, since small establishments employ disproportionate numbers of minimum-wage workers. To investigate this issue, County Business Patterns data on the average number of employees per establishment for two-digit industry classifications (U.S. Department of Commerce, 1978) were merged with the CPS data. The logits for overtime pay compliance were then reestimated with the average-establishment-size variable as an additional control. The establishment-size variable was not statistically significant, and its presence did not alter the coefficients of the minimum-wage

dummy. Although this method of controlling for firm size is less than perfect, the results suggest that the compliance tests reported here are not seriously biased by the absence of micro-level data on employer size.

The estimated effects of the other variables on overtime pay compliance are qualitatively similar to those reported in the noncompliance probits of Ehrenberg and Schumann (1982a). Most notably, overtime pay compliance is considerably higher among union than nonunion workers. Under the fixed-wage model, in which overtime pay regulation imposes real costs upon firms and creates incentives for noncompliance, unions can be interpreted as policing organizations which increase the likelihood that noncompliance is recognized and reported to enforcement agencies. The fixed-job model, on the other hand, cannot easily explain why any variables other than minimum-wage status would be systematically related to overtime pay compliance, unless these variables are correlated with wage flexibility or the feasibility of making binding agreements over weekly earnings and hours packages.

V. Hours-of-Work Distributions

As discussed above, the fixed-wage model implies that the overtime pay provisions of the FLSA should increase the prevalence of a 40-hour work week. However, the well-known fact that the hours-of-work distribution has a spike at 40 hours does not by itself constitute supporting evidence for the fixed-wage model, since it is shown below that this spike occurs even among workers not subject to overtime pay regulation. Other factors obviously have much to do with the popularity of a 40-hour work week, so corroboration of the fixed-wage model requires finding a relatively larger spike in the covered sector.

In the simple fixed-wage model examined here, overtime pay regulation has no effect on those with work weeks below the statutory hours standard; therefore, the hypothesis to be tested is that, of those who work at least 40 hours during a given week, the

¹⁷The \$3.00-per-hour wage dummy remained statistically insignificant in logits that excluded the minimum-wage dummy. It still might be argued that minimum-wage workers in general are less likely to receive overtime pay, and so the pattern of overtime pay detected in the covered sector would also be found among noncovered workers. To test this conjecture, I reestimated the overtime pay logits including noncovered as well as covered workers and adding dummy variables to identify covered workers, minimum-wage workers, and covered minimum-wage workers separately. The results suggest that, as implied by the fixed-job model, being simultaneously covered by overtime pay regulation and at the minimum wage has a negative effect on the probability of receiving overtime pay which operates independently from either coverage status or minimum-wage status considered alone. This conclusion requires caution, however, because the data contain few noncovered minimum-wage workers, and therefore it is difficult to identify separately the effect of minimum-wage status for covered and noncovered workers.

probability of working exactly 40 hours should be higher for covered than for non-covered employees. Note that the fixed-job model, on the other hand, predicts that such an increased likelihood of working a 40-hour week should be found only for those covered employees earning the legal minimum wage, since, for all other employees, compensating adjustments in the straight-time hourly wage can take place to circumvent the overtime law.

Simple frequencies reveal that, although both the covered and noncovered sectors display a marked tendency for work weeks to mass at 40 hours, the tendency may be more pronounced in the covered sector. This lends some support to the fixed-wage model. For example, of those in the 1974 data who worked at least 40 hours during the survey week,¹⁸ 68 percent of covered employees worked exactly 40 hours, whereas only 55 percent of noncovered employees worked a 40-hour week. The corresponding numbers for the 1976 data are 70 percent of covered employees and 55 percent of noncovered employees. For 1978, the situation is reversed, with a greater propensity to work a 40-hour week in the noncovered sector (71 percent) than in the covered sector (65 percent). However, this reversal arises primarily because of the switch in the coverage status of state and local government employees. If these workers are excluded, then the pattern in 1978 is similar to the earlier years.

Lending support to the fixed-job model, however, is the fact that in each year the proportion working 40-hour work weeks (rather than working overtime) is around 80 percent for covered minimum-wage workers, which is considerably higher than for nonminimum-wage workers. Although sug-

gestive, these raw frequencies are not conclusive, because they do not control for other factors influencing the adoption of a 40-hour work week, and some of these other factors are likely to be correlated with coverage status.

Therefore, to provide a more convincing test of the implications just discussed, the logits reported in Table 5 were estimated. The sample now consists of all individuals (both covered and noncovered) who worked at least 40 hours during the survey week, and the dependent variable is a dummy indicating those individuals who worked exactly 40 hours. The independent variables include those used in the compliance regressions reported in Table 4, with the addition of dummy variables identifying individuals covered by the overtime pay provisions of the FLSA (OTCOVER) and covered minimum-wage workers (OTCOVER $\times$ MINWAGE). As before, the coefficients of the industry, occupation, and geographic dummies are not reported.

The estimates for 1974 and 1976 indicate that covered employees are much more likely to work a 40-hour week, even when other determinants of work-week length are held constant. These results corroborate the fixed-wage model and contradict the fixed-job model. On the other hand, the coefficient of OTCOVER is negative and statistically insignificant in 1978, which is consistent with the fixed-job model.¹⁹

Additional support for the fixed-job model is provided by the positive and relatively large coefficients estimated for the interaction term between OTCOVER and MINWAGE. This effect, which is somewhat smaller and less statistically significant in 1978, suggests that the positive influence of coverage status on the probability of working a 40-hour week is larger for minimum-wage than for nonminimum-wage

¹⁸ May versions of the CPS provide information both on usual weekly hours of work and on hours actually worked during the survey week. Because respondents may be predisposed toward giving a standard answer such as 40 hours to the question about usual weekly hours of work, the results reported here use the data on hours worked during the survey week. However, the analysis was replicated using the alternative measure of weekly hours, and similar results were obtained.

¹⁹ When state and local government employees are excluded, the coefficient of OTCOVER becomes positive but remains statistically insignificant in 1978, while the coefficients for 1974 and 1976 do not change. This sample exclusion does not affect the estimated impact of the interaction term between OTCOVER and MINWAGE.

TABLE 5—HOURS-DISTRIBUTION LOGITS (DEPENDENT VARIABLE = HOURS40)

Variable	1974		1976		1978	
	Coefficient	Derivative	Coefficient	Derivative	Coefficient	Derivative
OTCOVER	0.5728 (0.1350)	0.1257	0.6992 (0.1289)	0.1496	-0.1436 (0.0977)	-0.0322
MINWAGE	-1.1577 (0.8420)	-0.2540	-1.3064 (0.6643)	-0.2794	-0.2028 (0.4107)	-0.0454
OTCOVER × MINWAGE	1.5538 (0.8540)	0.3409	1.5260 (0.6843)	0.3264	0.7104 (0.4371)	0.1592
WAGE	0.0120 (0.0174)	0.0026	-0.0132 (0.0116)	-0.0028	-0.0449 (0.0128)	-0.0101
AGE	0.0029 (0.0020)	0.0006	0.0007 (0.0020)	0.0001	0.0038 (0.0019)	0.0009
EDUC	-0.0257 (0.0110)	-0.0056	-0.0212 (0.0108)	-0.0045	-0.0270 (0.0104)	-0.0061
UNION	0.3562 (0.0570)	0.0781	0.3865 (0.0568)	0.0827	0.4101 (0.0536)	0.0919
MARRIED	-0.2156 (0.0580)	-0.0473	-0.2161 (0.0571)	-0.0462	-0.1446 (0.0506)	-0.0324
FEMALE	0.9715 (0.0689)	0.2013	0.7779 (0.0667)	0.1664	0.7723 (0.0610)	0.1731
BLACK	0.5707 (0.0924)	0.1252	0.4586 (0.0869)	0.0981	0.2681 (0.0798)	0.0601
NONWHITE	0.3300 (0.2718)	0.0724	0.1070 (0.2184)	0.0229	0.7804 (0.1833)	0.1749
CITY	0.1128 (0.0647)	0.0247	0.1746 (0.0647)	0.0373	0.0807 (0.0609)	0.0181
SUBURB	0.0428 (0.0585)	0.0094	0.1031 (0.0583)	0.0221	0.0120 (0.0540)	0.0027
GOVTEMP	0.6721 (0.1104)	0.1474	0.5286 (0.1058)	0.1131	0.5180 (0.1097)	0.1161
Log likelihood:	-5,267.1		-5,291.3		-6,289.0	
Sample size:	9,006		9,175		10,470	

Notes: Standard errors are given in parentheses. The samples consist of employees who worked at least 40 hours during the survey week and for whom coverage status could be determined. Also included as independent variables were dummy variables indicating major industry, major occupation, and census geographic division. Derivatives of the probability of working exactly 40 hours with respect to the independent variables were calculated using the mean sample frequencies: 0.675 in 1974, 0.690 in 1976, and 0.661 in 1978.

employees. This additional effect for minimum-wage workers was confirmed in logits estimated on the sample of covered workers only. Of the remaining variables, it is apparent that workers who are less educated, unionized, unmarried, female, minority, employed by the government, or residing in a standard metropolitan statistical area (SMSA) are more likely than others to work the standard 40-hour week instead of a longer work week.

VI. Compensation

The fixed-job model presented in Section II asserts that straight-time hourly wages

adjust to leave weekly earnings and hours unaffected by the overtime pay provisions of the FLSA. This section analyzes the wages and earnings of individual workers in order to determine whether such a straight-time wage differential exists and whether this differential is large enough to completely neutralize overtime pay regulation.

A. Straight-Time Hourly Wage Rates

The fixed-job model with perfect wage flexibility predicts weekly earnings to be equal for identical individuals working the same weekly hours at jobs that differ only in terms of whether or not they are subject to

the overtime pay provisions of the FLSA. One can write this earnings equality as

$$(2) \quad wH = w^c H \quad \text{if } H \leq \bar{H}$$

$$(3) \quad wH = w^c [\bar{H} + b(H - \bar{H})] \quad \text{if } H > \bar{H}$$

where w^c and w represent straight-time hourly wages in the covered and noncovered sectors, respectively, and the remaining variables are as defined in Section II. Note that, under the type of hedonic equilibrium envisioned by the fixed-job model, wages vary with hours of work, but for notational convenience the dependence of w on H has been suppressed above. Overtime pay regulation does not affect the wages of those who do not work overtime; therefore, equation (2) implies $w^c = w$ for identical workers in identical jobs with $H \leq \bar{H}$. The above equations implicitly assume that overtime pay exists only to comply with the FLSA, and so no workers in the noncovered sector receive overtime pay, whereas all workers in the covered sector receive the minimum overtime pay required by law (i.e., an overtime premium of exactly b after exactly $\bar{H}$ weekly hours of work). The effects of relaxing this assumption will be reported below.

Using the fact that $\bar{H} + b(H - \bar{H}) = H + (b - 1)(H - \bar{H})$, equation (3) can be rewritten as

$$(4) \quad w/w^c = 1 + (b - 1)(H - \bar{H})/H \\ \equiv V > 1 \quad \text{if } H > \bar{H}.$$

V represents the straight-time wage premium necessary in the noncovered sector to produce equality in weekly earnings between this sector and the covered sector that receives overtime pay. The size of V depends on the length of the work week (H) as well as on the parameters of overtime pay regulation (b and $\bar{H}$), and it is intuitively clear why V must be increasing in H and b and decreasing in $\bar{H}$. Taking logs of equation (4) yields

$$(5) \quad \log(w^c) \approx \log(w) - (b - 1)(H - \bar{H})/H \\ \text{if } H > \bar{H}$$

where I have used the approximation that

$$\log(V) \approx (b - 1)(H - \bar{H})/H$$

since $(b - 1)(H - \bar{H})/H$ is small. Therefore, in the presence of overtime pay regulation, the structure of straight-time hourly wages is given by equation (5) for those who work overtime, and by $w^c = w$ for those who do not work overtime.

To derive an estimating equation from (5), specify straight-time hourly wages in the absence of overtime pay as $\log(w_i) = X_i\beta + \varepsilon_i$, where X represents a vector of worker characteristics, β is a vector of parameters, ε is a random error term, and i indexes the individual. Then the foregoing discussion suggests estimating a log(wage) equation of the form

$$(6) \quad \log(\text{WAGE}_i) = X_i\beta + \alpha[(H_i - \bar{H})/H_i] \\ \times \text{OTCOVG40}_i + \varepsilon_i$$

where WAGE is the straight-time hourly wage and OTCOVG40 is a dummy variable identifying those individuals who are both covered by overtime law and actually working overtime (i.e., $\text{OTCOVER} = 1$ and $H > \bar{H}$). The term $(H - \bar{H})/H$ represents overtime as a percentage of total weekly hours and is calculated for each individual using the CPS data on usual weekly hours of work and setting $\bar{H} = 40$ as required by the FLSA.²⁰ From equation (5), it is clear that the fixed-job model predicts $\alpha = -(b - 1) = -\frac{1}{2}$ in the above regression, since the FLSA currently requires $b = 1.5$. The fixed-wage model, on the other hand, provides no rationale for why straight-time wages should be inversely related to coverage status and overtime hours in this way. In other words,

²⁰ Because the earnings measure used in later analysis refers to usual weekly earnings, the hours measure employed here is usual weekly hours of work, rather than hours worked during the survey week. In addition, this measure should best reflect an individual's typical work week, since reported hours during the survey week can be affected by sick leave, holidays, vacation days, etc.

estimates of $\alpha = -\frac{1}{2}$ would provide evidence of the completely offsetting adjustment of straight-time wages to overtime pay regulation predicted by the fixed-job model, whereas $\alpha = 0$ implies the absence of any such adjustment, as is assumed by the fixed-wage model.

Before proceeding with the empirical analysis, however, it is necessary to discuss issues related to the specification and estimation of equation (6). First, note that the wage equation to be estimated is neither a labor-demand nor labor-supply function, but rather the type of equilibrium wage-hours locus described in Lewis (1969) and Rosen (1974). Because hedonic equilibrium generally requires that wage rates vary with hours of work, weekly hours enter this equation through the X vector as well as through the variable capturing the effects of overtime pay regulation. Therefore, the regressions reported below include usual weekly hours of work entering as a quadratic in the X vector.²¹

Other variables in the X vector are the human-capital measures and demographic characteristics typically included in wage equations. The human-capital variables are education, age, and age-squared. Dummy variables identifying marital status, union membership, and government employment are added because these variables are known to be correlated with wages. To control for regional cost-of-living differences, I include dummies indicating whether the individual resides in the central city of an SMSA or elsewhere in an SMSA, as well as a vector of dummies identifying the census geographic division of residence. Major industry and occupation dummies are included in an attempt to account for differences in the composition of the covered and noncovered sectors. Finally, I also introduce a dummy variable indicating coverage status under the

overtime law (OTCOVER), thus allowing the intercept in the wage equation to differ across sectors. In effect, OTCOVER picks up straight-time wage differentials between covered and noncovered individuals who do not work overtime, and these wage differentials will be attributed to compositional differences between the covered and noncovered sectors. By contrast, the coefficient α in equation (6) measures straight-time wage differentials between overtime workers in the covered and noncovered sectors, and it is these wage differentials that provide a test of the fixed-job model.

The empirical work in Sections IV and V focused on the behavior of minimum-wage workers, and therefore it was necessary to keep the sample as large as possible in order to observe an adequate number of these workers. The empirical work in the present section, however, affords the luxury of restricting the sample to a more homogeneous group so that any wage or earnings differentials detected between covered and noncovered workers will not simply reflect crude demographic differences across the two sectors. Accordingly, all of the wage and earnings regressions reported here restrict the sample to white males aged 18–64 who usually work at least 20 hours per week.²²

Table 6 presents ordinary least-squares estimates of equation (6).²³ Columns 1, 3,

²¹ Experiments in which the X vector was generalized to include interactions between hours and other variables in the X vector produced similar results to the specification in which hours was not interacted, so only estimates of the simpler specification are presented here.

²² I also exclude individuals covered by and earning the legal minimum wage, since these workers have their hourly wage rate fixed by law, and so the fixed-job model does not apply to them. Because they comprise a small fraction of the total sample, including these workers does not change the results. Regressions that included those who usually work fewer than 20 hours per week also produced similar estimates, as did regressions that included women and nonwhites.

²³ Because only estimates of the market wage-hours locus are sought, and not estimates of the underlying structure of worker preferences and firm technology, the empirical analysis presented here need not tackle the problems associated with structural estimation in implicit markets that have been described by James N. Brown and Harvey S. Rosen (1982) and Dennis Epplé (1987). See Brown and Rosen (1987) for a recent study that also uses least squares on micro-data to estimate a hedonic wage locus. The hedonic locus estimated in

TABLE 6—HOURLY-WAGE REGRESSIONS [DEPENDENT VARIABLE = LOG(WAGE)]

Variable	1974		1976		1978	
	(1)	(2)	(3)	(4)	(5)	(6)
$[(H - \bar{H})/H]OTCOVER$	-0.2278 (0.0697)	-0.1903 (0.0704)	-0.1777 (0.0678)	-0.1281 (0.0688)	-0.2127 (0.0694)	-0.2448 (0.0701)
OTCOVER	—	-0.0638 (0.0173)	—	-0.0719 (0.0175)	—	0.0425 (0.0139)
HOURS	0.0161 (0.0031)	0.0166 (0.0031)	0.0180 (0.0027)	0.0181 (0.0027)	0.0138 (0.0027)	0.0134 (0.0027)
HOURS ² /100	-0.0155 (0.0034)	-0.0167 (0.0034)	-0.0148 (0.0028)	-0.0156 (0.0028)	-0.0092 (0.0029)	-0.0084 (0.0029)
AGE	0.0333 (0.0018)	0.0334 (0.0018)	0.0376 (0.0020)	0.0375 (0.0020)	0.0359 (0.0019)	0.0357 (0.0019)
AGE ² /100	-0.0370 (0.0023)	-0.0371 (0.0023)	-0.0413 (0.0024)	-0.0411 (0.0024)	-0.0386 (0.0023)	-0.0384 (0.0023)
EDUC	0.0231 (0.0014)	0.0230 (0.0014)	0.0266 (0.0015)	0.0266 (0.0015)	0.0287 (0.0014)	0.0286 (0.0014)
UNION	0.2273 (0.0072)	0.2265 (0.0072)	0.2738 (0.0076)	0.2731 (0.0076)	0.2812 (0.0071)	0.2807 (0.0071)
MARRIED	0.0856 (0.0087)	0.0856 (0.0087)	0.0817 (0.0089)	0.0815 (0.0088)	0.0741 (0.0081)	0.0739 (0.0081)
CITY	0.0724 (0.0090)	0.0710 (0.0090)	0.0541 (0.0093)	0.0536 (0.0093)	0.0074 (0.0092)	0.0074 (0.0092)
SUBURB	0.1071 (0.0077)	0.1056 (0.0077)	0.0882 (0.0081)	0.0870 (0.0081)	0.0541 (0.0078)	0.0542 (0.0078)
GOVTEMP	-0.0073 (0.0145)	-0.0021 (0.0146)	0.0116 (0.0141)	0.0166 (0.0141)	0.0317 (0.0157)	0.0482 (0.0166)
R ² :	0.4953	0.4964	0.5042	0.5055	0.5061	0.5067
Sample size:	6,407		6,521		7,357	

Notes: Standard errors are given in parentheses. The samples consists of white males aged 18–64 who usually work at least 20 hours per week and for whom coverage status could be determined. Also included as independent variables were dummy variables indicating major industry, major occupation, and census geographic division.

and 5 exclude the coverage dummy OTCOVER, whereas columns 2, 4, and 6 report results when this variable is included to help control for wage differences between the covered and noncovered sectors that are unrelated to whether overtime is worked. Estimates of α occupy the first row of this table. In all three years, the estimate of α is negative and statistically significant, providing evidence that straight-time wage differentials arise in response to overtime pay regulation. However, for all three years, one can also reject the hypothesis that $\alpha = -\frac{1}{2}$, which implies that the wage adjustment is less than complete. Including OTCOVER in the regressions causes the estimates of α

to become less negative in 1974 and 1976, because in these years covered workers are found to earn lower wages independently of the effect of overtime pay regulation, whereas the opposite situation occurs in 1978.²⁴ However, in no year does α change by enough to overturn the previous conclusion that straight-time wages adjust significantly but incompletely to the presence of overtime pay regulation. These regressions support the existence of a partial wage adjustment that falls somewhere between the

²⁴The sign reversal that occurs on the coefficient of OTCOVER in 1978 is related to the U.S. Supreme Court decision that caused many state and local government employees who were classified as covered in the 1974 and 1976 data to become noncovered in the 1978 data. See the discussion in Section III.

that paper is between the mean level of the hourly wage and its variance.

predictions of the fixed-wage and fixed-job models of overtime pay regulation.²⁵ The coefficients of the other variables generally appear reasonable in both sign and magnitude, although the estimated rate of return to education is quite low.

The empirical analysis conducted above required knowledge of the overtime pay coverage status of individual workers, as well as strong assumptions about the structure of overtime pay in the covered and noncovered sectors. It is therefore useful to discuss how sensitive the results are to these assumptions. As described in Section III, every effort was made to eliminate from the sample individuals whose coverage status under the overtime pay provisions of the FLSA could not be accurately assigned, but it is inevitable that some of the remaining individuals have been misclassified. If the fixed-job model is correct, classification errors of this type would bias estimates of α in the positive direction, since some covered workers with lower straight-time wages are

being misclassified as otherwise identical noncovered workers, who would be expected to have higher straight-time wages, and vice versa. On the other hand, if the fixed-wage model best represents the truth, then no bias results from misclassification, since straight-time wages should be unrelated to coverage status. Therefore, any potential bias arising from errors in assigning coverage status works against the fixed-job model.

It was also assumed that no workers in the noncovered sector receive overtime pay, whereas all workers in the covered sector receive the minimum overtime pay required by law: an overtime premium of time and a half for weekly hours of work past 40. Although the assumptions that $b = 1.5$ and $\bar{H} = 40$ are probably not very objectionable, some union contracts specify an overtime premium of double time or above and a standard work week under 40 hours. Potentially more important assumptions are that overtime pay exists only to comply with the FLSA and that there exists perfect compliance within the covered sector. The compliance frequencies presented above indicated that about 10 percent of covered employees who worked overtime during the survey week were not paid an overtime premium as required by the FLSA, and many noncovered employees received overtime pay despite the lack of legal compulsion. To gauge the effect of these exceptions, the wage regressions were reestimated excluding union members from the sample and also excluding overtime workers in the covered sector who were not paid an overtime premium and those in the noncovered sector who were paid an overtime premium. These exclusions produced only minor changes in the estimates of α .

Finally, as noted above, weekly hours of work enter equation (6) through two avenues. The separate effect of overtime pay regulation is in large part identified by the fact that the reciprocal of weekly hours enters the term $[(H - \bar{H})/H]OTCOVG40$ but is excluded from the hedonic wage-hours locus of noncovered workers. The specific functional form of this term is a direct implication of the fixed-job model, but hedonic

²⁵The extent to which straight-time wage differentials arise in response to the statutory overtime premium may vary across demographic groups, perhaps because wage flexibility or the feasibility of making binding agreements over weekly earnings and hours packages varies across sectors. In particular, the high-turnover jobs typically held by young, uneducated workers might not involve the implicit earnings-hours contracts envisioned by the fixed-job model. To investigate this possibility, wage regressions were estimated in which the variable capturing the effects of overtime pay regulation was interacted with a dummy variable identifying those workers 25 years of age or less without a high school diploma. Since only about 7 percent of the sample in each year meet this definition of "unskilled," it is not surprising that the estimates of α for the rest of the sample are very similar to the estimates in Table 6 that constrain α to be the same for skilled and unskilled workers. The point estimates of the interaction term for 1976 and 1978 imply that α is close to zero for unskilled workers in these years, which is consistent with the conjecture just discussed. However, in the 1974 regressions, unskilled workers receive a straight-time wage differential that is more than twice the size of that received by skilled workers, and in no year is this interaction term statistically significant. I also explored similar types of interactions with age, education, union status, and, for the extended sample, race and sex. These interactions generally failed to achieve statistical significance and did not exhibit consistent sign patterns across the three years.

nic theory functional. Therefore, the reciprocal of wage-hours and that the reciprocal of the noncovered estimates of α ranging from errors of interpretation data. On the reported in context of no obvious results are wage-hours.

The use of CPS provides for the effect. The fixed-jobs-hours pay coverage model predicts hours of work covered income thereby qu premium. I implies that by covered amount of

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$$(7) \log(\lambda)$$

If the fix

nic theory provides little guidance as to the functional form of the wage-hours locus. Therefore, it could be argued that the reciprocal of weekly hours also belongs in the wage-hours locus of noncovered workers and that the estimates of α in Table 6 merely reflect this misspecification. When the reciprocal of weekly hours is added to the noncovered wage-hours locus, the estimates of α become statistically insignificant, ranging from -0.10 to 0.10 with standard errors of around 0.09 . Thus, this alternative interpretation is also consistent with the data. On the other hand, the estimates of α reported in Table 6 make sense within the context of the fixed-job model, and there is no obvious reason for this to occur if the results are primarily due to a misspecified wage-hours locus.

B. Weekly Earnings

The usual-weekly-earnings data in the CPS provide an alternative way of testing for the effects of overtime pay regulation. The fixed-job model implies that the earnings-hours locus is unaffected by overtime-pay coverage status, whereas the fixed-wage model predicts that weekly earnings (given hours of work) should be higher for those covered individuals who work overtime and thereby qualify for the statutory overtime premium. In addition, the fixed-wage model implies that the earnings advantage enjoyed by covered workers should increase with the amount of overtime worked.

The implications of overtime pay regulation for the structure of weekly earnings can be derived in a fashion very similar to that used above for straight-time wages. For individuals who are both covered by overtime pay regulation and working overtime, the natural logarithm of weekly earnings can be written as

$$(7) \log(Y^c) = \log(w^c) + \log(H) \\ + (b-1)(H - \bar{H})/H \\ \text{if } H > \bar{H}.$$

If the fixed-job model is correct, then

$\log(w^c)$ adjusts to overtime pay regulation as specified in equation (5). Substituting (5) into (7), the term $(b-1)(H - \bar{H})/H$ vanishes, and therefore the fixed-job model predicts the statutory overtime premium to have no effect on weekly earnings. According to the fixed-wage model, on the other hand, straight-time wage rates are independent of overtime pay regulation, and so the earnings-hours locus is shifted outward for covered overtime workers.

Assuming as before that straight-time wages in the absence of overtime pay are given by $\log(w_i) = X_i\beta + \varepsilon_i$, one can test these implications of the fixed-job and fixed-wage models with a log(earnings) regression of the form

$$(8) \log(\text{EARNINGS}_i) \\ = Z_i\gamma + \delta[(H_i - \bar{H})/H_i] \\ \times \text{OTCOVG40}_i + \varepsilon_i$$

where the vector Z includes $\log(H)$ in addition to all variables in the vector X described earlier and γ is a vector of coefficients. The fixed-job model implies $\delta = 0$, whereas the fixed-wage model predicts δ to be positive and on the order of $\frac{1}{2}$.

Table 7 reports estimates of equation (7).²⁶ Consistent with the fixed-job model, overtime pay regulation does not appear to have much effect on the earnings-hours locus. The estimates of δ never achieve statistical significance, are negative in 1974, and in the other years are always less than a third of the value predicted by the fixed-wage model.²⁷ The coverage dummy

²⁶The weekly-earnings regressions in Table 7 are estimated on slightly larger samples than the hourly-wage regressions reported in Table 6 because of the fact that hourly-wage data are missing more often than weekly-earnings data. For the years being studied, reported weekly earnings of \$1,000 or more are coded as \$999 in the May CPS. Individuals for whom the usual-weekly-earnings variable has been truncated in this way are excluded from the sample.

²⁷Unlike the straight-time wage regressions, estimates of the effects of overtime pay regulation from weekly-earnings regressions change very little when the reciprocal of weekly hours is added as a regressor.

TABLE 7—WEEKLY EARNINGS REGRESSIONS [DEPENDENT VARIABLE = LOG(EARNINGS)]

Variable	1974		1976		1978	
	(1)	(2)	(3)	(4)	(5)	(6)
$[(H - \bar{H})/H]OTCOVG40$	-0.1202 (0.0898)	-0.0325 (0.0920)	0.0263 (0.0915)	0.1254 (0.0946)	0.1403 (0.0855)	0.1132 (0.0879)
OTCOVER	—	-0.0756 (0.0175)	—	-0.0733 (0.0182)	—	0.0193 (0.0146)
HOURS	-0.0217 (0.0241)	-0.0393 (0.0245)	-0.0440 (0.0218)	-0.0619 (0.0222)	-0.1453 (0.0208)	-0.1404 (0.0211)
HOURS ² /100	0.0058 (0.0132)	0.0142 (0.0133)	0.0130 (0.0117)	0.0214 (0.0118)	0.0731 (0.0113)	0.0709 (0.0115)
log(HOURS)	1.7675 (0.5022)	2.1429 (0.5090)	2.4167 (0.4550)	2.7973 (0.4642)	4.3824 (0.4328)	4.2769 (0.4401)
AGE	0.0352 (0.0019)	0.0352 (0.0019)	0.0366 (0.0020)	0.0364 (0.0020)	0.0365 (0.0019)	0.0364 (0.0019)
AGE ² /100	-0.0396 (0.0023)	-0.0397 (0.0023)	-0.0400 (0.0025)	-0.0398 (0.0025)	-0.0397 (0.0024)	-0.0396 (0.0024)
EDUC	0.0221 (0.0015)	0.0220 (0.0015)	0.0257 (0.0015)	0.0256 (0.0015)	0.0289 (0.0015)	0.0288 (0.0015)
UNION	0.2233 (0.0073)	0.2222 (0.0073)	0.2655 (0.0077)	0.2644 (0.0077)	0.2678 (0.0074)	0.2677 (0.0074)
MARRIED	0.0809 (0.0088)	0.0807 (0.0087)	0.0862 (0.0091)	0.0860 (0.0091)	0.0818 (0.0085)	0.0817 (0.0085)
CITY	0.0715 (0.0090)	0.0697 (0.0090)	0.0377 (0.0095)	0.0374 (0.0095)	0.0028 (0.0096)	0.0028 (0.0096)
SUBURB	0.1079 (0.0078)	0.1061 (0.0078)	0.0875 (0.0083)	0.0865 (0.0083)	0.0574 (0.0081)	0.0574 (0.0081)
GOVTEMP	-0.0098 (0.0147)	-0.0046 (0.0147)	0.0195 (0.0143)	0.0245 (0.0143)	0.0306 (0.0162)	0.0380 (0.0171)
R ² :	0.5225	0.5238	0.5579	0.5590	0.5529	0.5530
Sample size:	6,854		6,774		7,594	

Notes: Standard errors are given in parentheses. The samples consist of white males aged 18–64 who usually work at least 20 hours per week and for whom coverage status could be determined. Also included as independent variables were dummy variables indicating major industry, major occupation, and census geographic division.

OTCOVER is once again introduced to control for earnings differences between the covered and noncovered sectors that are unrelated to overtime, and OTCOVER picks up significant differences, but the same basic conclusion remains: overtime pay regulation does not significantly increase weekly earnings.

It is somewhat puzzling that the analyses of hourly wages and weekly earnings yield different estimates of the extent to which overtime pay regulation is circumvented. Straight-time wages appear to adjust in the direction implied by the fixed-job model, but by less than half as much as would be necessary to offset overtime pay regulation completely. The weekly-earnings regressions, on the other hand, suggest that adjustment is close to complete. There is evi-

dence, however, that some respondents do not include overtime pay when answering the usual-weekly-earnings question in the May CPS, and this may explain why the regressions reported above find that coverage under overtime pay regulation has little effect on the weekly earnings of those who work overtime.²⁸ If the hourly-wage ques-

²⁸ Using the information provided on usual weekly hours, hourly-wage rates, and receipt of premium pay for overtime hours, I was able to calculate an alternative weekly-earnings measure for most individuals in the earnings sample. For overtime workers who receive premium pay, this alternative measure is on average 15–20 dollars higher than the response to the usual-weekly-earnings question, whereas the two measures are similar on average for those who do not work overtime or do not receive premium pay.

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tion in the CPS provides accurate information on straight-time wage rates. then the regressions using this variable are likely to be more reliable than those using weekly earnings, and therefore it is probably prudent to favor the conclusion of a sizable but incomplete wage response to overtime pay regulation over the competing conclusion of full adjustment.

VII. Conclusion

This paper has analyzed the economic effects of the overtime pay provisions of the Fair Labor Standards Act. Two alternative approaches to modeling the impact of overtime pay regulation were shown to produce dramatically different implications. In particular, the labor-demand approach adopted by previous studies assumes that the straight-time wage is independent of the statutory overtime premium. This fixed-wage assumption implies that overtime pay regulation should reduce overtime hours, increase the prevalence of a 40-hour work week, and raise the weekly earnings of overtime workers. The fixed-job approach, on the other hand, assumes that firms and workers agree to packages of weekly hours and weekly compensation, and therefore changes in the statutory overtime premium can be neutralized by offsetting adjustments in the straight-time hourly wage. As a result, weekly hours and earnings are unaffected by overtime pay regulation. Because workers earning the minimum wage are legally precluded from experiencing reductions in their straight-time wage rates, the fixed-job model predicts overtime pay regulation to have a differential impact on minimum- and nonminimum-wage workers, with no substantive economic effects expected for nonminimum-wage workers.

The empirical analysis suggests that neither of the simple models of overtime pay regulation considered here can completely account for observed labor-market outcomes. In accordance with the fixed-job model, the overtime law appears to have a greater impact on minimum-wage workers, as reflected by the findings that overtime pay compliance is significantly lower for

these workers and the prevalence of a 40-hour work week is significantly higher. On the other hand, overtime pay compliance is higher for union than for nonunion workers, a result more easily reconciled with the fixed-wage model of overtime pay regulation. In addition, the finding that overtime-pay coverage status systematically influences the hours-of-work distribution for nonminimum-wage workers is supportive of the fixed-wage model. No significant differences in weekly earnings were discovered between the covered and noncovered sectors, which is consistent with the fixed-job model. However, the analysis of hourly wages indicates a substantial but incomplete adjustment of straight-time wages to overtime pay regulation.

Overall, the data analyzed here suggest that wage adjustments occur to mitigate the purely demand-driven effects predicted by the fixed-wage model, but these adjustments are not large enough to neutralize overtime pay regulation completely. The offsetting adjustments that do occur serve to limit the potential usefulness of overtime pay regulation as a job-creation device.

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POTENTIAL GOP Proposal

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"THE MINIMUM WAGE FOR FAMILIES ACT"

LEGISLATIVE DESCRIPTION AND SUMMARY

This proposal will fundamentally redesign the EITC, and rename it the "Working Families Support Credit".

RATIONALE

It has become difficult in recent years to support a family on a minimum-wage salary. There is agreement among both Republicans and Democrats that we need to provide assistance to the "working poor", but there is significant disagreement on the best way to accomplish this goal.

The administration has proposed an increase in the minimum wage as the solution to this problem. While such an increase would provide some relief to the working poor, it would also have much more far reaching effects, including placing large economic constraints on the private sector, a loss of entry-level positions, and an inflationary ripple effect on wages. A minimum wage increase would also affect those persons who arguably are not in need of this assistance, such as teenagers working during their summer vacation.

Our proposal would accomplish the goal of providing assistance to those who are truly in need -- working families -- while at the same time avoiding the additional problems associated with a minimum wage increase.

BACKGROUND

The Earned Income Tax Credit (EITC), which was created in 1974, provides a refundable tax credit to lower-income working families with children and currently to some adult childless workers. The EITC has expanded greatly since its creation as a result of both Congressional and Presidential initiatives, including efforts by the Reagan, Bush and Clinton administrations.

RECIPIENTS

Under current law, there are an estimated 18.2 million tax units eligible for EITC. 12.7 million of these tax units are families with children, of whom roughly 5.3 million have one child and 7.4 million have two or more children. The remaining 5.5 million eligible tax units are childless workers ages 25 through 64.

PROPOSAL

This EITC reform proposal, which builds upon the reforms in the Republican Balanced Budget Act of 1995, will redesign and reform the current EITC program in an effort to return the program to its original purpose of serving low-income working families. The proposal will address the following:

- Convert large annual "lump sum" EITC payments into equal monthly payments so as to more practically supplement family income
- † ~~Deny credit to undocumented workers~~
- Eliminate credit for childless adults
- Increase the support credit for parents
- Rename Earned Income Tax Credit the "Working Families Support Credit"

With the savings generated from these reforms, we will significantly increase the amount of credit recipients of the Working Families Support Credit would receive.

If you believe that those people who are in need of wage assistance are America's working families, as opposed to teenagers employer during their summer vacation, please join us in support of The Minimum Wage Increase for Families Act.

If you would like to cosponsor this legislation or if you have additional questions, please contact Chuck Seyfarth with Representative Hutchinson at 5-4301.

The Minimum Wage for Families Act

A proposal to create a three tiered minimum wage to lift incomes of poor families with children. The three wage rates are :

Individuals	\$4.25 an hour
Families with 1 child	\$7.00 an hour
Families with 2 or more children	\$8.00 an hour

How does it work ?

Employers would be able to hire as many job applicants as possible at the current starting wage of \$4.25. The Federal government would provide families with children a monthly cash payment to bring these families up to the \$7 or \$8 level as outlined above. The payments would be administered through the Internal Revenue Service.

How much would it cost ?

This proposal is expected to be scored by the Joint Tax Committee to save at least \$15 billion over 6 years. Much needed reforms of the poorly designed Earned Income Tax Credit will provide significant savings that will be used to increase assistance to those families that actually have to raise children. Any additional savings generated from reforms of the EITC program will be used to finance the \$500 per child tax credit available to all low-income and middle class families.

How does it fit with the Republican Tax Cut proposal ?

The Minimum Wage for Families Act can be easily integrated into the \$500 per child tax credit proposal. When combined, all families, whether they earn \$4.25 or more an hour, will see their take home pay increase because of this proposal.

How does it complement the Republican Welfare Reform proposal ?

Under the Republican welfare reform proposal, as many as 7 million able-bodied adults on public assistance will be asked to work. Small business can not create 7 million jobs for these often poorly educated individuals at the same time that Democrats want to increase the cost for hiring these workers.

It's Take Home Pay, Stupid

Change in Hourly Take Home Pay for a Family of Four

