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HIGHLIGHTS

Do Institutions Affect the Wage Structure?

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Debate about the minimum wage most often focuses narrowly on its possible effects on the small segment of the labor force (around 6 percent) that earns the minimum wage. But if such a small segment is earning the minimum wage, why is it so significant in the public debate? The narrow focus has obscured the critical issue of the importance of the effect the minimum wage has on the larger number of workers who earn around the minimum wage and, hence, on the distribution of income.

This brief expands the focus of the debate by discussing the effect the minimum wage can have on workers earning around the minimum wage and by demonstrating that institutions, such as the minimum wage, unionization, and right-to-work laws, affect not just those workers earning exactly the minimum or members of unions but the overall wage structure. This is demonstrated by showing that workers in states with a high level of unionization have a lower probability of earning the minimum than workers in states with right-to-work laws, even when educational and market factors are accounted for.

The theory of perfect competition in labor markets predicts that a minimum wage causes unem-

ployment if it is higher than the equilibrium wage. Results of empirical studies of a correlation between increases in the minimum wage and increases in unemployment have been mixed. Some studies find little or no disemployment effect, and most of those that do show a disemployment effect suggest that that effect is primarily in the teen labor market. Card and Krueger (1998) found that in the states they examined employment actually rose after an increase in the minimum wage.

The question of who earns the statutory minimum wage is open to debate. Although it is widely believed that most are teenagers, some studies have found that most are adults with

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economic responsibilities (Mishel, Bernstein, and Schmitt 1999). However, a more crucial question is who earns a wage close to the minimum wage. The claim that the level of the minimum wage is unimportant because most people earn a higher wage obscures the impact the minimum wage has on a range of wages above and below it. The impact is explicitly analyzed in wage contour theory, first developed by John Dunlop (1957). Dunlop suggested that the wage structure of a firm is affected as much by external forces as internal ones. An economy's overall wage structure can be thought of as a series of wage contours—a contour being defined as a range of wages earned by a group of workers with similar characteristics and working in similar industries. In each industry there is a key rate, changes in which affect the rates surrounding it, and that key rate varies from industry to industry. The minimum wage or a union wage may be the key rate in a particular wage contour. Spriggs and Klein's (1994) study of the minimum wage appears to reinforce Dunlop's wage contour theory. If the minimum wage is, as they suggest, a socially defined reference point,

that reference point can be altered and its alteration will have an impact on those wages around it.

State Type and Regional Disparity in Income Distribution

The impact of institutions on the wage structure can be assessed by seeing whether wages vary with institutional structure (defined in terms of the minimum wage, union density, and the attitude of the legal structure toward unionization). To estimate the probability that an individual worker will earn a wage around the minimum, we used demographic profiles drawn from the Integrated Public Use Microdata Series (IPUMS) for 1940 to 1990 (Ruggles and Sobek 1997). Earnings "around the minimum wage" are defined as the statutory minimum wage plus or minus 50 percent of the minimum. From the data sets, consisting of a household file and a personal file, we extracted data on heads of household who are employed and who work for wages (as opposed to salaries).

Table 1 State Types and Union Density (Percentage of Unionized Workers)

Right-to-Work States		High-Union-Density States		Remaining States*	
Alabama	13.6	Alaska	24.1	Colorado	9.9
Arizona	8.0	California	17.7	Delaware	13.0
Arkansas	7.8	Connecticut	20.2	Kentucky	12.6
Florida	7.3	District of Columbia	15.1	Maryland	14.9
Georgia	6.8	Hawaii	24.6	Missouri	14.6
Idaho	8.1	Illinois	20.2	New Hampshire	12.6
Iowa	12.1	Indiana	16.5	New Mexico	9.4
Kansas	10.2	Maine	15.6	Oklahoma	9.3
Louisiana	7.0	Massachusetts	16.2	Vermont	9.3
Mississippi	5.2	Michigan	23.7		
Nebraska	9.1	Minnesota	20.3		
Nevada	20.2	Montana	15.8		
North Carolina	4.2	New Jersey	21.9		
North Dakota	10.0	New York	27.7		
South Carolina	3.3	Ohio	18.5		
South Dakota	7.7	Oregon	20.1		
Tennessee	9.5	Pennsylvania	18.9		
Texas	6.5	Rhode Island	19.4		
Utah	9.0	Washington	21.0		
Virginia	6.7	West Virginia	16.3		
Wyoming	11.2	Wisconsin	17.7		

*Remaining states are neither right-to-work nor high-union-density states.

Source: Data from Barry T. Hirsch and David A. Macpherson, *Union Membership and Earnings Data Book: Compilations from the Current Population Survey 1996 Edition* (Washington, D.C.: Bureau of National Affairs, 1996), Table 8.

Table 2 Per centage of Employed Heads of Household Earning around the Minimum Wage, by State Type*

Year	All States	RTW	Difference between RTW and All States (Percentage Points)	HUD	Difference between HUD and All States (Percentage Points)	Difference between HUD and RTW (Percentage Points)	Difference between RTW and HUD as a percent of HUD
1940	29.9	37.0	7.1	26.7	-3.2	10.3	38.6
1950	28.4	36.2	7.8	24.6	-3.8	11.6	47.2
1960	19.3	26.5	7.2	15.7	-3.6	10.8	68.8
1970	17.0	22.8	5.8	13.8	-3.2	9.0	58.0
1980	19.7	23.7	4.0	17.3	-2.4	6.4	37.0
1990	14.2	16.8	2.6	12.4	-1.8	4.4	35.5

* RTW, right-to-work states; HUD, high-union-density states.

Note: On the basis of chi-square tests, all differences are significant at the 95 percent confidence level. “Around the minimum wage” is defined as the minimum wage plus or minus 50 percent of the minimum.

Source: Author’s calculations from the IPUMS [Steven Ruggles and Matthew Sobek et al., *Integrated Public Use Microdata Series: Version 2.0* (Minneapolis: Historical Census Projects, University of Minnesota, 1997)].

To construct a model for analyzing differences in wage structure among states, states are divided into three categories (Table 1). “Right-to-work states” are those that have right-to-work laws (an indication of an attitude generally favorable to business and hostile to unionization). “High-union-density states” have union densities over 15 percent and no right-to-work laws (union density is the percentage of the labor force belonging to unions). A third category covers the remaining states, which are neither right-to-work nor high-union-density.

When the minimum wage is conceived as a range of wages, the population of workers that we are dealing with naturally increases. In 1940, 0.4 percent of employed heads of households earned exactly the statutory minimum wage; however, in that same year, 29.9 percent of employed heads of household earned around the minimum wage (Table 2).

The difference between state types in the percentage earning around the minimum narrowed from 1940 to 1990, but it was still significant in 1990. If educational levels are generally lower in right-to-work states, it would follow that workers in those states are more likely to earn around the minimum wage. But when educational factors are controlled for, workers with little education in right-to-work states are at least two to three times more likely to earn around the minimum wage than those with little education in high-union-density states.

The persistent difference between state types is especially important because the 1980s was a period of intensive economic development, especially in the South, where every state has right-to-work laws. Development alone was insufficient to bring the percentage of the labor force earning around the minimum wage down to the level prevailing in high-union-density states. After years of economic development the portion of heads of household earning around the minimum wage is still 35.5 percent (4.4 percentage points) higher in right-to-work than in high-union-density states.

The Minimum Wage as a Means to Achieve a More Equitable Distribution of Income

Where unions are difficult to organize, that is, in right-to-work states, the minimum wage becomes, in effect, the only labor market institution that can prop up wages, especially for those at the bottom of the wage structure. Regional differences might suggest the need to think about how the minimum wage could be used to equalize wage disparities between the states. From a national perspective, there is no gain when one state lures industry away from another, especially if the federal government is required to bear the burden of providing assistance to regions that lose industry to low-wage states.

One option is to raise the minimum wage in high-union-density states, where the gap between the statutory minimum wage

and the median hourly wage is considerably greater. Although this strategy might have the virtue of narrowing the earnings gap between workers in high-union-density states, it would widen wage disparities between state types and would create further differences, with states having the higher minimum attracting the higher-skill and higher-wage jobs and those having the lower minimum attracting the lower-skill and lower-wage jobs. Another option is to have a higher minimum in states with lower wage rates so as to reduce the tendency of firms to relocate in search of lower wages, but such a policy is not likely to be politically feasible.

Neither option should be pursued. There should continue to be a uniform federal minimum wage, but it should be raised. The minimum wage should not be used to equalize disparities between states, but to create a more equitable distribution of income throughout the country. By demonstrating that labor market institutions such as the minimum wage and unions can force wages up through various contours, it is hoped to show that a minimum wage can help increase the income of a broad segment of low-wage workers. If a higher minimum wage can increase the incomes of a large segment of the low-income population, it will substantially help to create a more equal and more equitable distribution of income. To the extent that raising the minimum wage will increase incomes for those at the bottom of the wage scale and will exert upward pressure on incomes of those earning around it, the income gap between those at the top and the bottom will narrow. The primary beneficiaries of minimum wage increases would be those at and near the bottom of the income distribution. This conjecture is consistent with literature suggesting that the declining value of the minimum wage in recent years has been a contributing factor to growing wage inequality (Galbraith 1998).

The minimum wage itself is not as important as the effect it has on the wage contours around it, an effect that is greater in states with lower wages, such as right-to-work states. The fact that opposition to the minimum wage and to increases in it has always been greater in the South and other right-to-work states, in which more workers earn around the minimum wage, suggests that the minimum wage has a greater impact on the distribution of income in

those states and that there is a political and economic interest in maintaining the existing wage structure. Therefore, the minimum wage can be conceived of in broader terms as an institution that can affect wage structure and therefore income distribution. The minimum wage must go beyond the narrow focus of employment consequences versus poverty benefits to those who earn the statutory minimum wage.

The minimum wage should, therefore, be used to obtain a more equitable income distribution. The minimum wage would be a more effective tool for achieving a more equitable income distribution if it were tied to an automatic adjustment mechanism such as a productivity index (Levin-Waldman 1998b). An increase in the minimum wage to \$7.25 an hour may not have as detrimental an effect as predicted by competitive market theory, but it would have a profound effect on the wages of people at the low end of the distribution of income. A higher minimum wage is in line with many living wage movements around the country and may not greatly affect employment in small businesses (Levin-Waldman and McCarthy 1998; Levin-Waldman 1999b). The minimum wage should be boosted to \$7.25 and then indexed to a productivity index thereafter. Although this would not completely reverse the pattern of growing wage inequality since the 1970s, it would be a positive step in that direction.

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