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The Minimum Wage Can Be Raised: Lessons from the 1999 Levy Institute Survey of Small Business

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In a 1999 Levy Institute survey of small businesses, more than three-quarters of the firms surveyed said their employment practices would not be affected by an increase in the minimum wage to $6.00. Their response makes it clear that the minimum can be raised to at least that level. The question now becomes how high can it be raised before serious employment consequences occur.

It is not uncommon for those opposed to increases in the minimum wage to allege that small businesses are likely to be hurt because the increase reduces their already relatively low profit margins and then they are forced to lay off workers. However, in a survey of small business conducted in 1998 at the Levy Institute, most of the respondents said that their hiring and employment practices were not affected by the most recent minimum wage increase (to $5.15 per hour in September 1997) and would not be affected if the minimum wage were increased to $6.00 (Levin-Waldman and McCarthy 1998). Although there is a vast literature that details adverse employment consequences (for example, Kosters and Welch 1972; Welch 1974, 1978; Meyer and Wise 1983; Neumark and Wascher 1992), the findings of the 1998 survey are consistent with studies that show that minimum wage increases have not had such consequences (most notably, Card and Krueger 1995, 1998). Moreover, other studies suggest that, contrary to the common supposition that youth and students are hurt, minimum wage increases actually shift employment toward them, especially in the fast-food industry (Lang and Kahn 1998), and that since 1980 the declining value of the minimum wage has been a contributing factor to increasing wage inequality, especially among women (Fortin and Lemieux 1997).

Such findings, in addition to concerns about the declining value of the minimum wage, have no doubt contributed to a new receptiveness among some economists and policymakers to minimum wage increases. However, a question still remains as to whether there is a limit to how far the minimum can be raised, that is, a question as to whether there is a "tipping point" at which considerable negative employment consequences will begin to occur. Even Card and Krueger recognize there is a limit, although they note that it has not yet been reached as the current minimum is well below the market-clearing wage. The responses to the 1998 Levy Institute survey suggest that $6.00 per hour is safely below the tipping point. In our initial report we therefore recommended that, at the very least, the minimum wage should be raised to $6.00 and thereafter increased by indexation, preferably to some productivity measure (Levin-Waldman 1998).

The Survey

A second small business survey was conducted by the Levy Institute in 1999. The survey asked questions about hiring and employment practices, educational and training preferences, wage structure, views of the role of government, and knowledge and use of various hiring and training incentive programs. The second survey was constructed to find out more about how small businesses are responding to changes in the welfare law and how various macroeconomic variables affect the health of small businesses. Both the 1998 and the 1999 surveys were conducted by telephone during the winter. The 1998 sample was a stratified, random sample across industry types of 560 firms with 1 to 500 employees. The 1999 sample was a nationally representative, simple, random sample across industry types of 536 small businesses employing between 5 and 500 workers. In the 1998 sample 65 percent of firms had between 5 and 500 employees--the number of workers employed by firms in the 1999 survey.1 Because of the small sample size, the findings cannot be said to represent the viewpoint of small business in general, but they do serve as a nonanecdotal indicator of the preferences of small

firms.

In both the 1998 and 1999 surveys, we asked firms whether an increase in the minimum wage to $6.00 per hour would affect their overall hiring or employment decisions. The percentage of firms that responded they would be affected declined from 20.7 percent in 1998 to 13.4 percent in 1999. When asked in the 1999 survey about an increase to $7.25 per hour,2 35.8 percent said they would be affected. The leap in percentage of affected firms at a wage of $7.25 suggests that although there may be room to raise the minimum wage above $5.15 per hour, there are limits to how high it can be raised.

Much of the conventional literature on the minimum wage maintains that minimum wage increases produce negative employment consequences and that these consequences are most pronounced for teenagers. According to this literature, businesses affected by the minimum wage will lay off workers. Of the 72 firms (13.4 percent of the total number surveyed) that stated their hiring and employment would be affected by an increase of the minimum wage to $6.00 per hour, 11 (15.3 percent) said they would be forced to lay off workers; the remainder would choose a different course of action (see Table 1). Over 40 percent of the affected firms at both wage rates would limit their total number of employees by hiring fewer additional workers rather than by laying off current workers.

There are some interesting differences between changes in hiring and employment practices in response to an increase to $6.00 and those in response to an increase to $7.25:

- The percentage of firms that would hire adults over teenagers drops from 5.6 percent at $6.00 to 3.1 percent at $7.25.
- The percentage of firms that would hire more experienced workers over less experienced almost triples from 5.6 percent at $6.00 to 15.1 percent at $7.25.
- The percentage of firms that would lay off current workers rises from 15.3 percent at $6.00 to 18.2 percent at $7.25.

The increase in the percentage that would lay off workers is important to note in trying to determine how severe any adverse employment consequences might be. There are several ways to measure such disemployment effects. One way is to measure the proportion of firms that would lay off workers as a result of a rise in the minimum wage. At $6.00 the disemployment effect would be 2.0 percent of firms surveyed and at $7.25 it would be 6.5 percent.

Another way is to measure the proportion of workers who would lose their jobs as a result of a rise in the minimum wage. A way to calculate this is to look at the number of laid-off workers relative to total number of workers employed. Out of 14,748 workers employed by the 536 businesses in the sample, only 363, or 2.5 percent, were paid the minimum wage. (Only 11.9 percent of the businesses in the sample had employees currently earning the minimum wage.) The 15.3 percent of employers who indicated that they would either lay off workers or reduce hours at $6.00 per hour (see Table 1) employed 62 of these minimum wage workers. If, as a worst case scenario, all these workers were to lose their jobs, the disemployment effect is only 0.4 percent (number of laid-off workers relative to total number employed). At a minimum of $7.25 per hour, the 18.2 percent of firms that would lay off or reduce hours employed 115 minimum wage workers; the disemployment effect under the worst case scenario is only 0.8 percent.

Estimates often place the disemployment effect for teenage workers at 1 to 3 percent for each 10 percent increase in the minimum wage. Given wage increases of 16.5 percent (from $5.15 to $6.00) and 40.8 percent (from $5.15 to $7.25), the adverse effect among survey respondents, when measured using bases of total workers and affected workers, is small (relative to that for teenage workers). That is, although it is true that the disemployment effect doubles as the minimum wage increases from $6.00 to $7.25, the effect is smaller than the effect estimated for all teenage workers. (For example, a 16.5 percent increase in the minimum wage would be expected to produce a disemployment effect between 1.6 and 5.0 percent, and a 40.8 percent increase would be expected to produce a disemployment effect between 4.1 and 12.2 percent.)

Table 1 Changes in Hiring and Employment Practices as a Result of an Increase in the Minimum Wage, 1999 Survey

	Increase to $6.00 per Hour (Percent)[a]	Increase to $7.25 per Hour (Percent)[b]
Would hire adult workers over teenage workers	5.6	3.1
Would hire more experienced workers over less experienced workers	5.6	15.1
Would hire more part-time workers and fewer full-time workers	4.2	3.6
Would hire more full-time workers and fewer part-time workers	4.2	2.1
Would hire fewer total workers	47.2	42.7
Would lay off current workers or reduce hours	15.3	18.2
Other (for example, raise prices)	15.3	12.0
Don't know	2.8	2.6

Note: Respondents were asked to indicate the one course of action they were most likely to pursue. Percentages may not total to 100 because of rounding.

[a] Percentage of the 72 firms that responded they would be affected by an increase to $6.00.

[b] Percentage of the 192 firms that responded they would be affected by an increase to $7.25.

It may be expected that the higher rise in the minimum wage would have a relatively larger disemployment effect. The fact that the results from this survey are smaller than those from others does not disprove the conventional theory. It rather may indicate that the minimum wage has not reached the tipping point or the level at which it "bites" (Freeman and Freeman 1991; Gordon 1995). If the tipping point would not be reached at $7.25, the argument for raising the minimum wage becomes even stronger. It may also suggest that something else is at work.

Wage Contours

An explanation can be found by looking at the effects of minimum wage increases on other segments of the labor force--those earning wages around the minimum. In a well-known essay John Dunlop (1957) suggested that the internal wage structure of a firm was affected as much by external as internal forces, and he proposed a theory of wage contours. In essence, the theory posits that an economy's overall wage structure can be thought of as a series of wage contours (with a contour representing a wage or a wage range for a group of workers

with similar characteristics working in similar industries). For example, contours might be defined as $5.15 (the statutory minimum), $5.16 to $6.00, $6.01 to $7.25, and so on. A change in a wage rate affects other wages within that wage range (or contour) and also has a ripple effect on the contours surrounding it; the nearer to the changed rate, the greater the impact. Thus, the statutory contour and the contour immediately above it will be most affected by changes to the statutory minimum. However, because of the ripple effect, employers (and employees) who do not pay (or earn) the minimum wage still have a considerable stake in any changes to that wage.

Table 2 Firms Affected by Increases in the Minimum Wage, by Entry-Wage Paid

Entry Wage	Would Your Firm Be Affected by an Increase to $6.00?	Would Your Firm Be Affected by an Increase to $7.25?
$5.15		
Yes	46.9	71.9
No	51.6	28.1
Don't know	1.6	0.0
$5.16 to $6.00		
Yes	25.3	69.5
No	73.7	29.5
Don't know	1.1	1.1
$6.01 to 7.25		
Yes	4.5	40.2
No	93.8	58.0
Don't know	0.0	0.9
$7.26 to 8.50		
Yes	2.1	14.7
No	97.9	85.3
Don't know	0.0	0.0

Note: 64 firms (11.9 percent of firms surveyed) paid $5.15; 95 firms (17.7 percent of firms surveyed) paid $5.16 to $6.00; 112 firms (20.9 percent of firms surveyed) paid $6.01 to $7.25; 95 firms (17.7 percent of firms surveyed) paid $7.26 to $8.50.

When the responses of the firms in the survey are viewed in the context of wage contours, they are not so anomalous after all. About half (50.5 percent) of the small businesses surveyed paid an entry-level wage between $5.15 and $7.25, and an additional 17.7 percent paid an entry-level wage between $7.26 and $8.50.3 The wage contour theory would lead us to expect that an increase in the minimum wage would affect not only those earning the statutory minimum but also those earning a wage close to the minimum, particularly those in the wage range immediately above the minimum (Spriggs and Klein 1994; Gordon 1996; Levin-Waldman 1999).

Not surprisingly, the percentage of firms saying that they would be affected by a wage increase drops as the entry-level wage rises, and the patterns appear to offer some support for the wage contour theory (see Table 2). Firms paying the statutory minimum or immediately above had the highest percentage saying they would be affected by an increase to $7.25. Of the firms farther removed from the minimum (those paying $6.01 to $7.25 and $7.26 to $8.50), over 93 percent said they would not be affected by an increase to $6.00, while 58 percent of those paying $6.01 to $7.25 and 85.3 percent of those paying $7.26 to $8.50 stated they would not be affected by an increase to $7.25.

Wage contour theory seems to indicate that since the minimum wage is likely to have its greatest effect on the contours just above it, it is not at all surprising that the disemployment effect should drop for employees of firms affected at $7.25. A critical issue in the minimum wage debate, therefore, is not the level of the statutory minimum itself or the costs and benefits of an increase in the wage for those earning it, but the impact of an increase in the minimum wage on firms paying wages around it. And this issue, unfortunately, has received little attention.

Public Policy

Despite the fact that most small businesses we surveyed would not be affected by an increase in the minimum wage, even up to $7.25, certain industries appear to be more sensitive to increases than others. Since the percentage of affected firms increases for a wage of $7.25, it would seem that this wage is getting closer to the tipping point, the point above which we are likely to see serious disemployment effects. Many municipalities have already enacted living wage ordinances that set a minimum wage for those doing business with them at around $7.25 per hour. Some set their wages even higher. However, no disemployment effects have been observed among employees of firms doing business with these municipalities (Pollin and Luce 1998).

Such a finding would suggest two possible avenues for public policy. At the very least the minimum wage could be raised to $6.00; this would have the advantage of affecting a smaller percentage of businesses than if the wage were raised to $7.25, but would have the disadvantage of falling somewhat below the level of a "living wage." The other is to take the bold step and raise the minimum wage to $7.25 and then tie any future increases to some index. Given that more than 60 percent of the small businesses we spoke to would not be affected by an increase to $7.25, an argument could be made that the bold step should be taken now, especially while the economy continues to be strong. The relatively low estimated disemployment effects make the argument for the bold step even stronger.

Given that more than 60 percent of the small businesses we spoke to would not be affected by an increase to $7.25, an argument could be made that the bold step should be taken now, especially while the economy continues to be strong.

The fact that a majority of the businesses we surveyed indicated they would not be affected by a wage increase to $7.25 is an indication that the current minimum wage is below the market-clearing wage. However, we can expect that disemployment effects will increase as the wage approaches a market-clearing wage.

The survey data also suggest the need for more research on wage contours to place the debate about the minimum wage in a larger context. For too long, discussion of the minimum wage has been narrowly framed in terms of a trade-off between youth disemployment effects and potential benefits to the poor.

The minimum wage was originally conceived as an element of macroeconomic policy with the goal of building up depressed wages and prices. As a society, we have an economic and moral interest in ensuring that those who work earn a wage that allows them to live in dignity above the poverty line. With appropriate consideration given to wage structure and employment consequences, the minimum wage can be used to boost incomes for those at the low end of the wage scale. Today there is the additional concern of growing wage inequality, and research into the relationship between the minimum wage and wage contours could provide some insight into means of narrowing the wage gap.

Notes

1.Although statistically the two samples are not strictly comparable because they were drawn from different (though not mutually exclusive populations) and there was some variation in the questions, there is enough overlap so that we can still derive valid information by looking at the responses to similar questions in the two surveys.)

2.The rate of $7.25 was chosen because it is a rate often put forth by living wage proponents as the wage that would be necessary to provide an acceptable standard of living.

3.The rate of $8.50 per hour was chosen as defining the next wage contour because it is the same dollar increase above $7.25 as $7.25 is above $6.00 ($1.25).

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Related Publications

For additional Levy Institute research on this subject, see:

Oren M. Levin-Waldman, *Small Business and Welfare Reform,* Public Policy Brief No. 51, 1999
