

Testimony on the Economic Impact of an Increase in the Minimum Wage
Finance Committee of the Santa Fe City Council, February 17, 2003
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Thank you for this opportunity to share my research with you. My name is Sam Bowles and I live at 624 Paseo de la Cuma (unit 9). I direct the Economics Program at the Santa Fe Institute. Since 1965 I have taught economics at Harvard University and the University of Massachusetts and have conducted research in economics, including the economics of labor markets, labor productivity, human resources, and income distribution. I have also served as an economic advisor to Senator Robert F. Kennedy and the Rev. Jesse Jackson during their Presidential campaigns, to the Rev. Martin Luther King, Jr., and President Nelson Mandela, as well as to the World Bank and the International Labor Organization. What I have to say this evening does not represent the views of any of these individuals or organizations. Let me also add that this testimony has not been sponsored or compensated by any organization.

The diverse and thoughtful testimony I heard in this room two weeks ago underscores the complex and potentially divisive nature of the question before you. The issues are indeed complex, but I hope to persuade you that the proposed increase in the minimum wage need not be divisive, and indeed may help to bring the family of Santa Feans closer together.

For those of you who are skeptical on this score, here is a true story. On the morning of January 5, 1914, a virtually unknown mechanic turned automobile producer named Henry Ford shocked his colleagues and competitors by announcing that he would pay his workforce a minimum of five dollars for an 8-hour day, at once shortening the work day and more than doubling the hourly rate of pay for the vast majority of his employees. For the lucky employees who were in the right place at the right time, the basic facts of work life inside the plant changed beyond recognition. The previous year Ford's labor force had averaged 13,623; During the course of that year 50,448 had walked out the door, most had quit; 8,490 had been fired. The year following the wage hike, employment had grown by a third, but the number quitting had fallen to a tenth of its earlier level, and only 27 employees had been discharged. Ford did not do it for the workers: profits rose, supported by a more than a twofold increase in output per hour of production labor. Ford was to become a household word around the world and *Fordism* a peculiarly American approach to labor relations: pay well and expect good work.

Santa Fe is not Detroit. Henry Ford was a gambling man whose gamble paid off. The members of this Council and your constituents do not wish to gamble with the profits of our businesses and the livelihoods of Santa Feans. What do we know about the likely impact of an increase in the minimum wage?

By far the most searching answer to this question is found a book by two authors recognized around the world as the top economists doing statistical studies of labor markets, David Card and Alan Krueger. The title of their book is, *Myth and Measurement: The new economics of the minimum wage*. The word “new” is significant because prior to its publication most economists adhered to a theory that predicted that minimum wages killed jobs. But blackboard economics was proven wrong in this case. The research in this book so successfully challenged this received wisdom that it won Card the John Bates Clark award from the American Economic Association as the outstanding U.S. economist under the age of 40. Krueger is the leading scholar in the labor economics program at Princeton University, and Card, since leaving Princeton, heads a similar program at the University of California at Berkeley. These are the top centers of research in labor economics in the U.S. Neither author, to my knowledge, has taken any public position pro or con concerning the question of living wages, or raising the minimum wage.

Card and Krueger investigated the effect on teenage employment of the increases in the federal minimum wage in 1991 and 1992, comparing high wage states where almost all workers were already paid in excess of the minimum with low wage states where the increase affected far more workers. They found – to their and most economists surprise -- that the states in which the larger number of workers were affected experienced employment *gains* relative to the states in which the increase in the minimum had less bite. Then they looked at the stock market valuation of firms with large numbers of low paid workers. They asked if news stories about the likely passage of minimum wage laws adversely affected the stock prices of such firms as Albertsons, Hilton Hotels, MacDonalds, Dairy Mart, and Kmart in subsequent days. They found either no effects, or small effects.

But their most telling evidence is also the most relevant to us, for it flatly contradicts some information provided to you in a report requested by the Chamber of Commerce. The authors studied employment in a random sample of fast food firms before and after the 1992 increase in New Jersey’s minimum wage. Comparing employment both in New Jersey and Eastern Pennsylvania, the authors found that employment in New Jersey actually increased compared to employment in Pennsylvania, though the difference was not large.

Not surprisingly, the restaurant industry funded a counter study. The letter soliciting participation in this study is worth quoting as it suggests the partisan nature of the effort:

Dear ___ (*franchise owner*)

I am writing to request data for research I am conducting in conjunction with the Employment Policies Institute, a restaurant-supported lobbying and research organization. In particular we [will] reexamine the New Jersey-Pennsylvania minimum wage study [this is the Card and Krueger study just

mentioned]

This is a rather unusual way to solicit data for scientific research. In the resulting study later published by the authors, the first footnote reports that the sponsoring organization (the EPI) “ is funded by business contributions and generally opposes minimum-wage increases.”

Sponsorship by an anti-minimum wage group does not in any way impugn the integrity of the authors of the study. But given the fact that a very large number of the firms contacted declined to respond, we are left with the worry that the above letter may have been taken by some as an invitation to not respond if, for example, they were New Jersey franchises that had experienced large increases in employment following the minimum wage hike. The controversy that continues about these two studies is complex and I will not attempt to induct you into the mysteries of econometrics that would be required for a thorough consideration of the issues. In my opinion, the combination of the high non response, the non random nature of the sample and the overtly partisan nature of the request for data makes the results of the EPI study suspect.

This business-sponsored counter study is the source of the key number in the memo by Dr. David Macpherson, namely the prediction that a ten percent increase in the minimum wage would result in a 2 percent decline in employment among Santa Feans. Those opposing the increase in the minimum wage have expressed concern for the well being of the affected workers, claiming that the good intentions of the advocates of the ordinance will lead to harm for those who they intend to help. In this respect they follow a venerable tradition, beginning with those who opposed the 19th century prohibition of child labor on grounds that it would impoverish working families.

But lets get to the numbers. I do not think this -0.2 is an accurate estimate. But in hoping that we can come to a common understanding of this issue, let us suppose that it *were* true. What would this imply for our workforce? Most individuals in low wage jobs have shorter than average job duration, and little job security. Movement between jobs is frequent. Let us consider the well being of such a worker over a period of years. If pay in her job rose 10 percent she could -- according to this number -- expect to be employed 2 percent less of the time, or perhaps to be employed the same number of weeks over this period, but 2 per cent fewer hours per week.

Now just for a reality check: please turn to the person beside you and ask if they would accept an offer of an 8 percent increase in income and a 2 percent reduction in working time. Or next time your have a meal out, ask your server.

The Chamber of Commerce and a number of business people understandably expressed concerns about a possible squeeze on their profit margins at the last hearing. I want to make two points about this concern. First, estimates of the effect of increases in minimum wages on the total costs of putting a product on the market suggest that the

impact is small. A New Orleans study found that a one dollar increase in the minimum wage would bring about a cost increase 2.2% in eating and drinking establishments and 1.7% in hotels, with lower figures in trade and other sectors, averaging for the entire city one percent or less. The higher figures may be more relevant for Santa Fe given the structure of our economy, but however they are averaged, they are small. The reason the cost impact is so small is that the pay of low wage employees is a small part of the total, once the cost of the physical plant, interest on borrowed funds, the materials, management salaries, taxes and the rest are considered. It is worth pausing to note that it was precisely eating establishments that formed the basis of the two New Jersey studies, so the New Orleans figures suggest that whatever effects on employment found there are probably an overestimate for other sectors of the economy.

The second point is obvious, but worth repeating. As anyone in business knows, profits taking a hit is not the only way an increase in costs can be accommodated. Productivity can increase to offset the cost hike, as it did at Ford. Paying a person more costs you more, but it buys you a different attitude and a stronger commitment to the firm. Management and owners might take home a bit less. If they did, it would not put a dent in the historically unprecedented explosion of inequality of earnings and wealth experienced in this country over the last two decades. But it would probably be a good thing for Santa Fe, the rest of the country might thank our businesses for the good example.

Finally, prices can rise. Suppose, just as a worst case scenario, that productivity could not be increased, that profits and managerial pay could not be shaded even a little bit, and that prices had to absorb the full impact of the cost increase. Would this drive jobs away? The Card and Krueger study found that New Jersey firms did increase prices to accommodate the wage cost increase; they apparently suffered no significant loss in business. What impact on our tourist and other businesses would we expect price increases in the neighborhood of 2 per cent to have?

Another reality check. Next time you eat out and somebody at the next table sounds like he came from Massachusetts, like me, or from Texas, ask if they would have stayed home, or spent their vacation in Albuquerque or Amarillo or Cape Cod if their \$25 meal had instead cost \$25.50 or their \$125 hotel room had cost \$127.50.

There is a larger issue here that I want to mention in closing, as it is an important one, but not one in which I have any special expertise. The quality of life in Santa Fe is something we cherish, and it also attracts visitors to our city. This quality depends critically on a belief which most of us share: it is that for all our glorious (and sometimes annoying) differences, we are connected by a fabric of respect, affection, curiosity about one another, tolerance and to some extent a common fate. Widening differences between what our wage earners make and what other Santa Feans have may tear at the threads making up this fabric. I know that most Santa Feans, business people, wage earners and others want to see this fabric enriched. I trust that you, Honorable Members, can find a way to do this for all of us.