Minimum Wage Policy after Seventy-Five Years
Historical and Contemporary Effects of the FLSA

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1. Introduction

Thank you Chairman Harkin, and all the members of the committee, for the privilege of speaking to you today. My task is to provide an overview of the impact of minimum wage legislation, enacted exactly 75 years ago in the Fair Labor Standards Act of 1938 and as amended subsequently on numerous occasions. I do so as a labor economist with over forty years of research on low-wage labor markets and as the author or co-author of numerous recent studies on minimum wage effects. My work has been published in the top refereed economics journals; in March 2013, the *Economic Report of the President* referred to my work in this area as "particularly compelling."

Congress passed the FLSA only after a long and heated political campaign. Similarly to much other landmark legislation, the initial law represented a compromise with significant exemptions, many of which were closed only in subsequent decades. Nonetheless, in his Fireside Chat of June 24, 1938, President Roosevelt had no doubts about the importance of the FLSA. Roosevelt made three key points: (http://millercenter.org/president/speeches/detail/3314)

"Except perhaps for the Social Security Act, it [the FLSA] is the most far-reaching, far-sighted program for the benefit of workers ever adopted here or in any other country. Without question it starts us toward a better standard of living and increases purchasing power to buy the products of farm and factory."

Roosevelt then referred to whether businesses could afford a wage floor, a topic that still forms the core argument of the policy's critics:

"Do not let any calamity-howling executive with an income of $1,000.00 a day, who has been turning his employees over to the Government relief rolls in order to preserve his company's undistributed reserves, tell you -- using his stockholders' money to pay the postage for his personal opinions -- tell you that a wage of $11.00 a week is going to have a disastrous effect on all American industry."

Roosevelt closed his discussion of the bill with an argument that one does not hear as often today:

"Fortunately for business as a whole, and therefore for the Nation, that type of executive is a rarity with whom most business executives most heartily disagree."

Was President Roosevelt correct about the far-reaching effects of the minimum wage provisions of the FLSA? In my comments today I argue that the national minimum wage has had important positive effects, but it is important to distinguish those effects according to the changing times. The minimum wage had a major and positive transformative effect upon the national economy in the 1930s and 1940s. After World War II, the minimum wage became an important pillar of the nation's shared prosperity, which characterized the national economy the through the 1970s.

Since the 1980s, the economic terrain shifted markedly: wage stagnation for the middle class, wage declines for low-wage workers and increases in pay inequality, especially at the top. In this context, minimum wage policies have nonetheless increased pay of low-wage workers without adversely affecting employment, and they have reduced both poverty and wage inequality.

I will also review economists' recent research on minimum wage effects in the U.S. My own research shows that minimum wages as high as $10.60 today do not have negative employment effects. These findings make sense if we take into account the very high levels of employee turnover, often in excess of 100 percent per year, and large numbers of job vacancies at any particular time, that characterize low-wage industries. In this too-often ignored context, economic theory as well as empirical evidence shows that minimum wage policies reduce turnover costs and job vacancies, but not employment.

2. The minimum wage from 1938 through the 1970s

The 1938 Act replaced a patchwork of 25 state minimum wages (mostly limited to women) with a uniform national floor covering about half of the workforce (agriculture and retail were excluded). The creation of a wage floor of $.25, together with the anticipation of the scheduled further increases, to $0.30 in 1939 and to $0.40 in 1945, helped end the downward spiral of money wages in the 1930s.

That downward spiral, as Keynes argued at the time, had prolonged and deepened the Great Depression. Stabilizing wages (and therefore also prices) had been a major concern among many business executives. And most American economists in that period were not opposed to establishing a national wage floor. Indeed, the then-current conventional wisdom, called the doctrine of high-wages, argued that higher worker purchasing power would create more economic growth.

In the immediate postwar decades, increases in the floor brought its level to a peak that is the equivalent of about $10.60 in today's dollars, or 46 percent higher than today's minimum of $7.25. Moreover, amendments in the 1960s and 1970s expanded coverage to nearly 80 percent of the nonagricultural private sector workforce by 1973 (Welch 1973, Table 2).[1]

In addition to helping reverse the downward national spiral of money wages, the national minimum wage helped transform many low-wage industries. These effects were most evident in the South, a region that was both much poorer than the rest of the U.S. and poorly integrated with the national economy. As the eminent Stanford economic historian Gavin Wright has shown, the FLSA-created floor was highly binding in Southern industry. But nonetheless, a more prosperous South, one with more employment growth and at higher wages, began to emerge after the passage of the Act. This

[1]Later extensions increased coverage much farther, to more retail and service workers, to public sector workers, to medium and large farms and to some domestic workers, although also adding a credit for tipped workers.

transformation was not foreseen by the bill's opponents, many of whom represented Southern states and districts. An equally dramatic upsurge in the South's fortunes occurred in the 1960s, after the FLSA extensions and the Civil Rights revolution (Wright 1986, 2013).

While the South gained relative to the national economy, the postwar era also was one of shared and rapid growth overall. Although it may seem surprising today, minimum wage increases then were designed not only to keep pace with inflation, but also to maintain equity with the growth of median wages—the wages received by the middle-class. Indeed, from 1939 through the 1970s, the federal minimum wage increased almost every five years, not only leapfrogging inflation, but also keeping a ratio of 48 to 55 percent for the minimum wage as a percent of the median wage (Welch 1973, Table 1; Dube 2013, Figure 6).

In the early postwar years, economists' thinking about the minimum wage changed significantly. In a 1946 theoretical paper, Chicago economist George Stigler noted that when the labor market is perfectly competitive a higher minimum wage had to reduce employment. Stigler also examined a very different labor market case: one in which recruiting workers incurs significant costs for employers. When "friction" replaces the costless adjustment mechanism assumed by perfect competition, a wage floor can reduce employers' recruitment costs, and a higher minimum wage could then *increase* employment. [2]

As a consequence, the actual effect of minimum wages could be known only by empirical research. Stigler's argument, referred to by economists as monopsony, became a feature of every undergraduate labor economics textbook. Most general economists, however, believing that the monopsony case was a quaint exception, were persuaded that minimum wages had to have negative employment effects.

Actual empirical research with microeconomic data on minimum wage effects began in the 1970s. These early studies were hampered by statistical issues that made it difficult to distinguish correlations from causal effects. Nonetheless, they suggested disemployment effects that were surprisingly small and limited primarily to teens.[3] Small effects could mean that the benefits to those receiving higher pay outweighed the costs to those displaced from jobs. And in a context of low overall unemployment, any displaced

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[2] For example, according to Seltzer (2002), the establishment of the FLSA led directly to high wages and higher employment in the Virginia tobacco industry in the 1930s. Seltzer interprets these results using the monopsony model. In 1974, as Gordon (1981) finds, the extension of minimum wage coverage to housekeepers reduced the decline in employment in that occupation. The 1974 extension did not include home care workers. According to the BLS' Occupational Employment Survey, in May 20120 home care workers earned about $1 less than housekeepers.

[3] An exhaustive review article by Brown et al. 1982 concluded that significant effects were limited to teens; for this group a 10 percent increase in the wage floor was associated with a 1-2 percent decline in employment. Reviews of later research studies (for example, Brown 1999; Neumark and Wascher 2008) reached the same conclusion.

workers would get others relatively easily. More economists began to approve of minimum wage policy for these reasons.

3. Minimum wage effects since the 1980s

The economic terrain shifted radically in the 1980s, to one of lower overall economic growth, stagnating real median wages and increased higher wage inequality. In the past three decades, federal minimum wage increases have not kept up with the real median wage. As a result, the ratio of the federal minimum wage to the median wage fell substantially, to a low of 32 percent in 2006. The ratio stands at 39 percent today, much lower than the 48-55 percent range of four decades ago. In response to the declining level and reach of the federal minimum wage, states have acted increasingly on their own and proposals to raise the federal floor and to close some of the remaining exemptions are again on the table.

As has been the case for several decades, the primary question is whether minimum wages create disemployment effects. Economists today can provide more credible studies than in previous years. We have much-improved statistical tools, better data and more elaborated understandings of frictional labor markets.

Federal increases, which by definition are national in scope, do not afford economists sufficient variation to credibly identify the causal effects of minimum wage increases. But state policies since 1985 and especially in the 2000s have generated increased variation in time and space in minimum wages. This increased variation gives economists greater ability to study the causal effects of minimum wages.

However, it is import to use controls that reduce rather than reinforce the confounding effects of other economic variables. The question of proper statistical controls arises because states that are more likely to adopt minimum wages are not randomly distributed; they are geographically clustered and differ in other labor market respects from states that are less likely to adopt minimum wage policies. The clustering is shown in Figure 1.

In a series of five papers using five different data sets and six different statistical approaches, my colleagues and I have used local controls, similar in spirit to those used in the famous David Card and Alan Krueger papers of the 1990s. To provide just one example: In Allegretto, Dube, Reich and Zipperer (2013) we compare all the pairs of counties that straddle a state border and that have had a minimum wage policy discontinuity in the past twenty years. (This study updates the Dube, Lester and Reich 2010 study that the *Economic Report of the President* and many economists have praised.) Figure 2 shows the counties that are included in such a study.

We find that failing to include controls for local labor market conditions creates a bias toward finding disemployment effects that are not there. This problem plagues dozens of studies, including almost all of those of David Neumark and William Wascher.

When we include such controls, we do find evidence that minimum wages increase actual wages, but no evidence that they reduce employment.

In a follow-up paper (Dube, Lester and Reich 2012), my colleagues and I examine, for the first time with U.S. data, the effects of minimum wages on rates of employee hires and separations. This study thus looks at worker flows in and out of jobs. We find that minimum wages have large negative effects on both types of worker flows. In other words, employers now have an easier time recruiting and retaining their workforce. This makes sense, given the large frictions—costs of recruitment and retention—among high-turnover low wage employers.[4]

4. Summary and conclusions

This whirlwind review of minimum wage effects since 1938 confirms President Roosevelt's view that the FLSA was both far-reaching and far-sighted. Minimum wage policy helped to eliminate the downward pattern of money wages in the 1930s, thereby removing one of the forces that had deepened and prolonged the Great Depression. In the immediate postwar decades, minimum wage increases were important in creating shared prosperity. In more recent decades, minimum wages have not kept up with inflation, but they nonetheless have increased low-wage workers' pay without creating negative employment effects.

I do not have here the space to discuss studies that have examined its other major effects, such as on poverty and pay inequality. Suffice it to say that careful studies show that the minimum wage reduces both (Dube 2013; Autor, Manning and Smith 2010).

A recent poll of high-ranking economists in all fields showed that a significant plurality now support minimum wage increases.[5] Put together with other polling studies, it seems clear that economists as a group, who were once more likely to oppose minimum wages, are now much more likely to support minimum wage increases.

The Great Recession and the subsequent weak job market recovery have eliminated and endangered millions of middle class jobs. In this new era, young workers can no longer count so much on minimum wage jobs as stepping stones into middle class careers. And middle class workers are increasingly looking at minimum wage rates as key reference points for their own level of economic security. This new context makes the case for minimum wage increases as compelling as ever.

[4] Our emphasis on the importance of local controls has been recently criticized by Neumark, Salas and Wascher (2013). However, as our newest paper (Allegretto et al. 2013) thoroughly documents, our further examination of this questions and even their own results show that local controls are indeed valid and that their proposed new methods are incorrect.

[5] http://www.igmchicago.org/igm-economic-experts-panel/poll-results?SurveyID=SV_br0IEq5a9E77NMV

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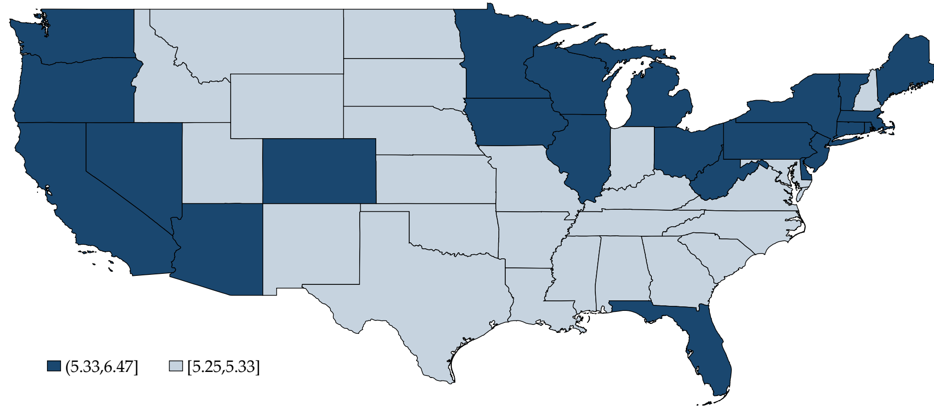
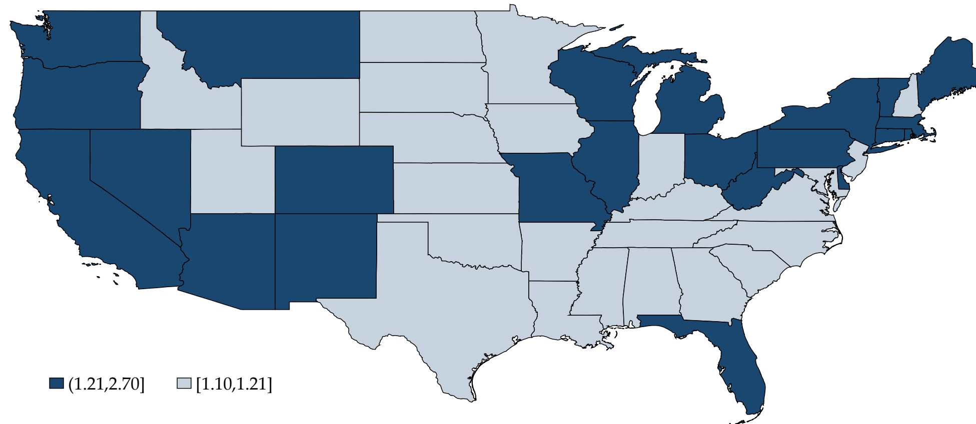
Figure 1 High versus low minimum wage states during 1990 – 2012: Means and variances

A. Minimum wage means



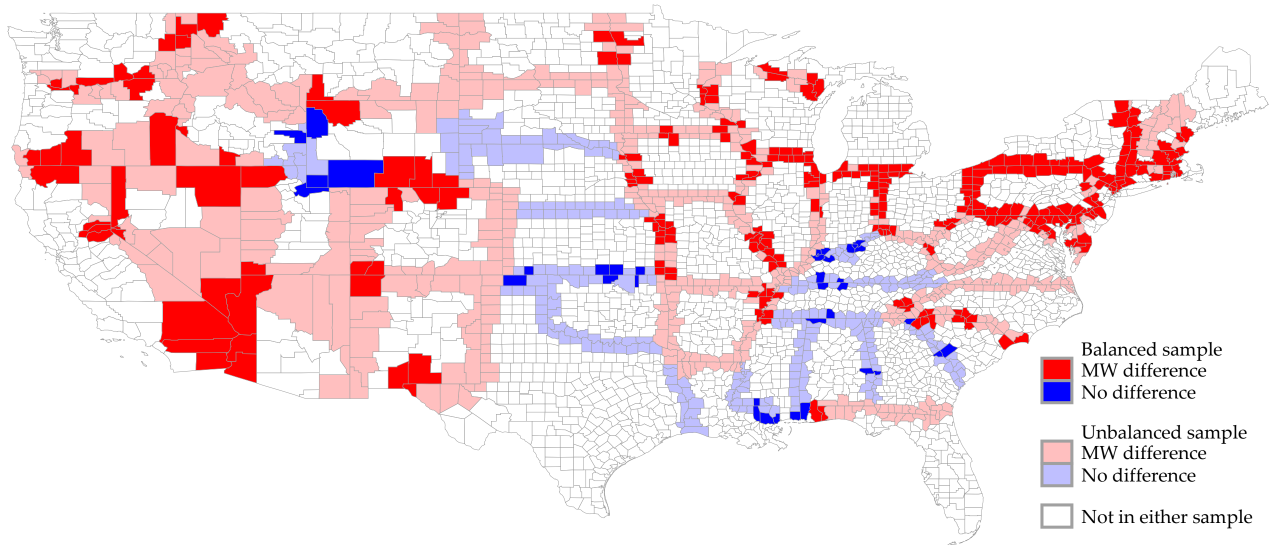
B. Minimum wage variances



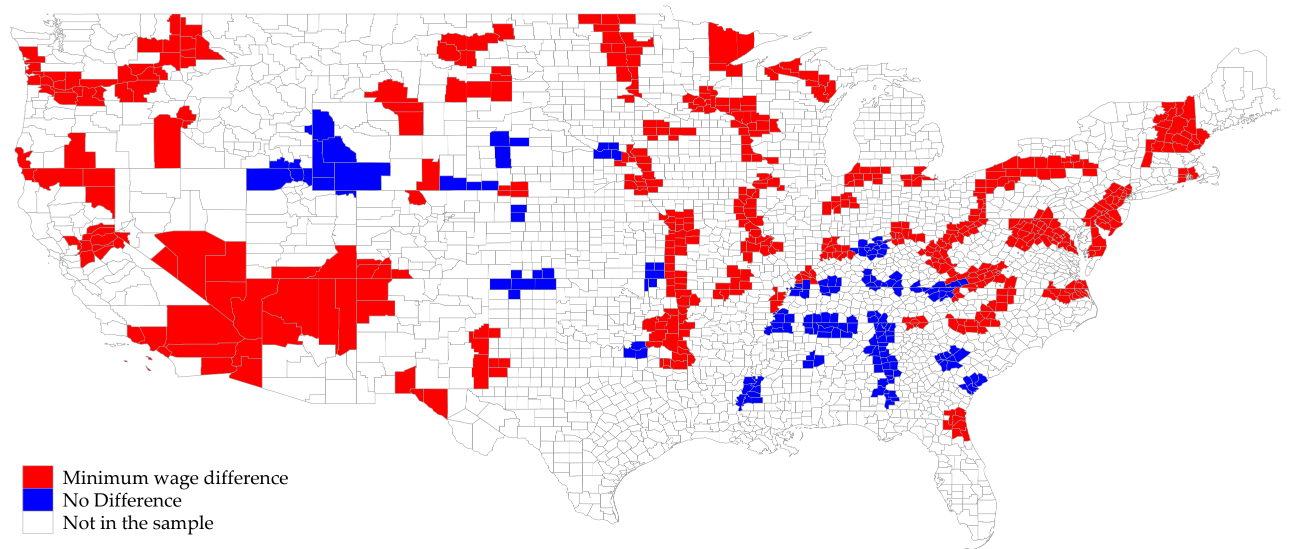
Notes. State means and variances calculated using annual state minimum wage data over 1990-2012. The shading on the maps partitions the states into above- and below-median values.

Figure 2 Maps of cross-state border county pairs and cross-state commuting zones

A. Cross-state border county pairs



B. Cross-state commuting zones



Notes. A: Red and blue colored counties indicate cross-state border county pairs. Counties colored red are part of pairs with minimum wage variation between the counties at some point in time in the sample. Darker shades indicate balanced sample. Balanced sample are those counties with employment and earnings information for all quarters, 1990-2010. Unbalanced sample includes those with limited information during that period. B: Red and blue colored counties constitute cross-state commuting zones. Counties colored red are part of commuting zones with minimum wage variation within the commuting zone at some point in time in the sample.