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PUBLIC POLICY

# POLICY

## BRIEFING

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### THE IMPACT OF MISSOURI'S PROPOSED \$6.50 MINIMUM WAGE ON THE LABOR MARKET

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A proposal on the November 2006 ballot would raise Missouri's minimum wage from \$5.15 to \$6.50 per hour. Supporters of the increase suggest that it would help the working poor. But in fact, evidence from the Current Population Survey casts doubt on that assumption. The higher minimum wage would provide a slight increase in income for the low-wage workers with the most skills and education. However, many less-skilled low-wage workers would be harmed.

The Current Population Survey provides data on and distinguishes between low-wage workers and people in poor households. Many low-wage workers live in households that are far from poor. Many are students; others live with a working spouse or with their parents. On the other hand, people in poor households earn an average wage that is several dollars per hour higher than the minimum. They are poor because they work few hours, not because they earn exceptionally low

wages. A minimum wage increase hurts poor workers because it causes firms to hire fewer low-skilled workers or to hire them for fewer hours.

The minimum wage increase would also be expensive. We estimate that the proposal would cost Missouri 18,500 jobs and would burden Missouri businesses with \$339 million in costs. The state of Missouri should focus on other policy solutions, such as the Earned Income Tax Credit, that are better targeted at workers that truly need help. The EITC lifts many workers above the poverty level without costing jobs or imposing large costs on businesses.

#### **Low-wage Workers and Poor Workers**

Data from the Census Bureau's March 2005 Current Population Survey show that the population of low-wage workers is very different from the population of workers in poor

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***We find that the proposed minimum wage increase would decrease employment by about 18,500 workers.***

households. We define low-wage workers as workers who earn less than \$6.50 per hour. They make up about 12 percent of the workforce. Low-wage workers are younger than the average worker: more than half are younger than thirty, compared with one quarter of all workers. Over one quarter of low-wage workers are students, compared with 7 percent of all workers. And 40 percent of low-wage workers live with their parents. Although low-wage workers don't earn much money themselves, they often live with family members who are considerably wealthier. In 2004, the average household income of low-wage workers was over \$57,000.

In contrast, workers in poor families tend to be older, and their wages tend to be higher. Workers in poor households earn an average wage of \$9.58 per hour—47 percent more than the \$6.50 per hour wage that would be mandated by the proposed increase. More than half of the workers in poor households already make more than the proposed \$6.50 minimum wage. Poor workers work fewer hours than the average worker. The typical poor worker works 1,120 hours per year, compared with 1,853 hours for the average worker. It is this difference in hours, and not low wages, that accounts for these workers' poverty.

### **Effects Of A Minimum Wage Increase**

An increase in the minimum wage would make employing workers more expensive. We would expect firms to respond to the change in wage by hiring fewer workers. The size of the drop in employment depends on how responsive

firms are to the price change. The best estimates in the economic literature suggest that a 10 percent increase in the minimum wage would cause employment to decrease between 1 percent and 3 percent. Firms in Saint Louis and Kansas City can more easily move to Illinois or Kansas and continue paying the wages they paid previously, so we assume that these firms would be more responsive to a minimum wage increase than firms located away from the border.

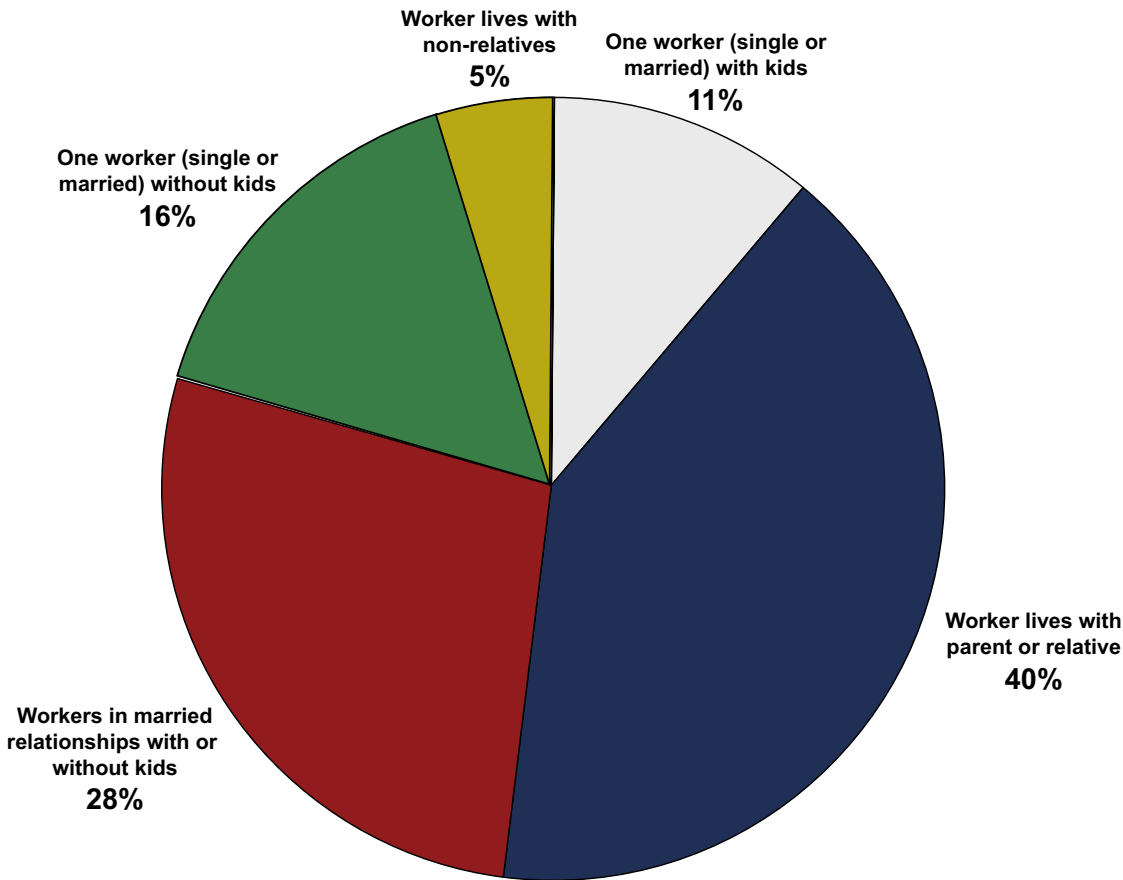
Based on the Current Population Survey, we estimate that there are about 355,700 Missouri workers who earn wages below \$6.50 per hour. Applying estimates of firm responsiveness from the economic literature, we find that the proposed minimum wage increase would decrease employment by about 18,500 workers. That represents about 5 percent of all low-wage jobs in Missouri.

Many workers who would benefit from higher wages are young and still in school. Their average household income is nearly \$60,000, and nearly one third of the workers who would see their wages increase live in households with incomes over four times the poverty level. Minimum wage increases are not well targeted towards helping the poor.

The proposed minimum wage increase would raise the incomes of those workers who got to keep their jobs by \$1,385 on average – an increase of 2.4 percent of their household incomes. However, this small benefit would come at a high price. Missouri firms would face a \$339 million increase in labor costs. And workers who would lose their jobs would see an average decline in income of \$6,906, a decrease of over 11 percent of



### Household Status of Low-Wage Workers



their household incomes. Although some workers would experience slight gains, others would suffer significant losses.

### Effects On The Poverty Rate

Because many workers in poor households earn wages above \$6.50 per hour, the proposed minimum wage increase would not lower the poverty rate by very much. At most, the poverty rate of low-wage workers might go down by 13 percent. Increasing work hours would do much more to reduce poverty. If all

low-wage workers worked full-time at their existing wages, the poverty rate of low-wage workers would fall by 35 percent. Increasing the number of work hours would be much more effective than raising the minimum wage at reducing poverty.

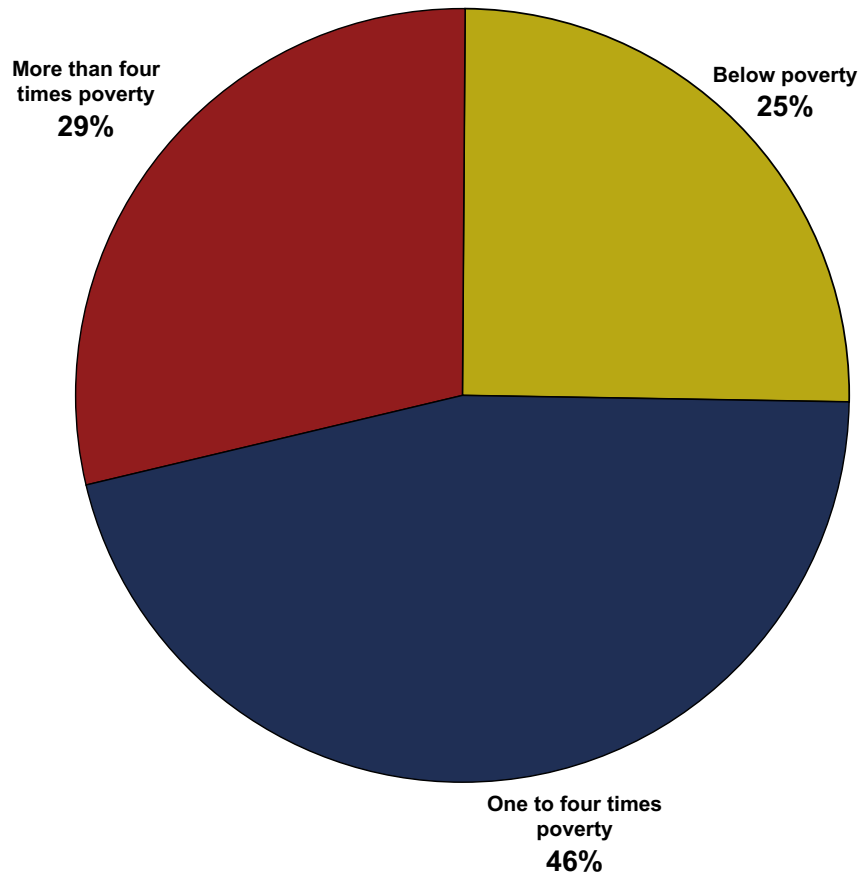
Low work hours, rather than low wages, hold workers below the poverty line. A minimum wage increase is a bad way to address the problem of poverty not only because it causes some workers to lose their jobs, but because it discourages firms from hiring workers for more hours. A higher minimum wage would reduce employment opportunities for

***A higher minimum wage would reduce employment opportunities for low-wage workers.***



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*Household Income of Low-Wage Workers*



low-wage workers. Instead of increasing the minimum wage, Missouri should consider implementing policies that would encourage poor workers to work more.

federal EITC. If all workers were employed full-time and received a state-level EITC equal to 15 percent of the federal EITC, poverty would be almost eradicated. Policymakers might also explore other solutions, such as job training programs and subsidies to child care that focus on poor families.

Such policies impose no direct costs on businesses, nor do they discourage firms from hiring unskilled workers. And they direct assistance where it is most needed.

### **An Alternative to a Minimum Wage Increase**

A government program designed to help low-wage workers already exists: the Earned Income Tax Credit (EITC). Rather than benefiting wealthy teenagers, the EITC helps only workers who live in low-income households. Fourteen states, including four of Missouri's neighbors (Illinois, Iowa, Kansas, and Oklahoma) grant state-level EITCs in addition to the

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***For more details, please see [Show-Me Policy Study no. 3](http://www.showmeinstitute.org), which is available at [www.showmeinstitute.org](http://www.showmeinstitute.org).***



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