THE MINIMUM WAGE AND THE WORKING POOR

by David J. Lyon

Poverty in the U.S. has persisted over decades in spite of a variety of efforts to combat it, fluctuating between 11 – 15% over the past forty years. While the most spirited debate often centers on the unemployed poor and why they're not working, that population only accounts for half of families in poverty, and includes the retired, the disabled and those looking for work. The other 50% of families in poverty contain at least one full-time worker.

Addressing poverty for some of these groups – seniors, the disabled, for example – seems a natural fit for publicly funded social programs, if a majority of the citizenry want to spend tax money on assistance for those in poverty (and a majority in the U.S. do). But the best approach to addressing poverty for the largest group, the working poor, is less obvious: they are able and they do work, they just don't make enough money to escape poverty. Understanding why their wages are below the poverty line is critical to identifying an effective intervention.

Are the working poor poor because "they don't have the skills to produce enough value for their employer to pay them more", or is it because "employers are not paying these workers fair wages (and can we define what 'fair wages' means?)"? On some level, this is an empirical question: "are these labor markets highly competitive or highly concentrated?" In highly competitive markets, competition for labor drives wages to the *competitive market wage*, where wages are very close to the value of workers' contribution to the company. By contrast, in non-competitive markets employers' high degrees of concentration and monopsony power (the buying market's sibling to monopoly power) enable them to pay workers significantly less than the competitive-market wage, and even further below their value to the company.

The two different answers to this question, are the working poor under-skilled or under-paid, point to very different policy responses. If the former is the main factor, then skill development programs, job matching services, GED support, higher ed assistance and the like can and do make a difference for many of the working poor.

If the latter root cause dominates – employers exercising outsized market power to push wages below their competitive-market rate – then effective interventions may focus on the minimum wage. Raising the minimum wage to the competitive-market rate functions as a market correction, restoring both wages *and* employment to their higher competitive-market rates, and eliminating the net economic loss to society that concentrated markets create (what economists call the "deadweight loss"). If, in addition, the competitive-market rate is higher than the poverty wage, then an appropriately-set minimum wage would bring those families out of poverty. Interesting to consider the possibility that such a minimum wage could eliminate half of family poverty by itself, and *it would be the economically appropriate (efficient) thing to do.*

I explore this question of "under-skilled or under-paid" and its ramifications in the paper *Working Poverty: Low Skills or Low Wages?,* recently published in *Challenge: The Magazine for Economic Affairs*. First, I assess the competitiveness of our biggest low-wage labor markets, food service and retail trade (together employing over 3 million low-wage workers), through three different lenses – the level of market concentration, estimates of the elasticity of the labor supply, and the response of employment levels to market changes. In each case, there are strong indications of monopsony power. There are also indications that monopsony's effects are strongest in low-wage markets (labor supply elasticity in one study trended upward with wages), meaning the working poor are especially vulnerable to wage suppression.

I proceed to estimate what wages would be if these markets were instead highly competitive. Using a simple model, I project that competitive-market wages in these industries would conservatively be in the range $11.50 - $12 / hr – just at or above the poverty line for a family of three. This paints a quite different picture than we may be used to for understanding both the root causes of working poverty, and its best solutions. Conventional wisdom tends to assume markets are competitive, that the working poor earn sub-subsistence wages because they are under-skilled or under-educated, and that reducing working poverty is basically a function of how many of our tax dollars we want to spend on it. Fortunately, monopsony power and its effects on wages are getting more attention in the media of late (for example, see Alan Krueger and Eric Posner's recent *Times* op-ed "Corporate America is Suppressing Wages for Many Workers").

Recognizing the presence of monopsony power points instead to wage suppression (through market power) as the main cause of working poverty, and to an above-poverty line minimum wage as an effective *and* efficient solution, funding the elimination of working poverty with the resources with which it was created. Under these conditions, the money to increase workers' wages above poverty level comes from corporate profit, returning to workers money that corporate profits had extracted from wages via the high degree of concentration in that labor market. Indeed, when we examine the annual profits of the largest of these low-wage employers, we see that they *can* afford – without raising prices – the complete cost of bringing wages above the poverty line entirely from profits (though in some cases it amounts to a sizable fraction of the total, from 10% to just over 50%).

Through this perspective, we get perhaps a more complete view of the minimum wage: when low-wage labor markets are concentrated and exhibit high degrees of monopsony power, raising the minimum wage – up to and including the competitive market rate – acts as a market correction, restoring fair wages to hard-working people. It also maintains or increases employment and maximizes what economists refer to as "total societal surplus" (which is equal to the sum of worker surplus and employer surplus). And it likely contributes to economic growth, as it redirects resources from profits (investors) to workers, who are likely to spend (i.e. return to the economy) a higher fraction of those resources. And since the competitive wage appears to be above the family poverty line, the proper minimum wage should bring millions of families out of poverty.