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THE EFFECT OF THE NEW MINIMUM WAGE LAW
IN A LOW-WAGE LABOR MARKET

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ABSTRACT

After nearly a decade without change, legislation that affected the Federal minimum wage in two significant ways took effect on April 1, 1990: (1) the hourly minimum wage was increased from \$3.35 to \$3.80; and (2) employers were enabled to pay a subminimum wage to teenage workers for up to six months. This paper examines the effect of these changes in the minimum wage law in a low-wage labor market using data from a survey of 167 fast food restaurants in Texas. We draw three main conclusions. First, our survey results indicate that less than 2 percent of fast food restaurants have taken advantage of the youth subminimum, even though 73 percent of the sampled restaurants paid a starting wage of less than \$3.80 before the new minimum wage took effect. Second, we find that a sizeable minority of fast food restaurants increased wages for workers by an amount exceeding that necessary to comply with the higher minimum wage. Third, the majority of fast food restaurants in Texas that were directly affected by the minimum wage increase did not report that they attempted to offset their mandated wage increase by cutting fringe benefits or reducing employment.

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After nearly a decade without change, legislation that affected the minimum wage in two significant ways took effect on April 1, 1990. First, the new legislation increased the hourly minimum wage from \$3.35 to \$3.80 on April 1, 1990, and will increase it again to \$4.25 on April 1, 1991. Second, the legislation enables employers to pay a subminimum wage to teenage workers for up to six months. The youth subminimum was enacted for a three-year trial period, and is to be evaluated by the Department of Labor at the end of the trial period. Although the Federal Labor Standards Act (FLSA) has permitted a limited subminimum wage for full-time students since 1961, the new legislation covers all teenagers and is much easier to administer. Essentially, employers may pay a subminimum wage to teenage employees for up to 90 days without providing any additional training. The subminimum wage can be extended an additional 90 days if the employer's training plan meets the Department of Labor's requirements, but no employee may be paid a subminimum wage for more than 180 days.¹

The subminimum wage was an important component of the Bush administration's minimum wage policy. Indeed, in June of 1989 President Bush abruptly vetoed the Kennedy-Hawkins amendments to the FLSA explaining, "I made it clear that I could accept an increase [in the minimum wage] only if it were a modest one, and only if it were accompanied by a meaningful training wage for new employees of a firm, to help offset the job loss" (Bureau of National Affairs, 1989).

The recent amendments to the minimum wage law provide the basis for three topics examined in this paper. The first topic we investigate relates to the newly enacted youth subminimum. We provide the first estimates of the

¹In addition, the subminimum wage cannot be applied to more than 25 percent of an employers' workforce hours, and the subminimum cannot be paid if an employee was laid off to make room for new subminimum-wage workers.

utilization of the subminimum wage. Comparisons of the wage distribution for 16-19 year olds and 20-21 year olds using Current Population Survey (CPS) data for 1989 and 1990 provide no evidence that employers are widely using the subminimum. In addition, we conducted a survey of 167 fast food restaurants in Texas to more directly measure utilization. Our survey results indicate that less than 2 percent of fast food restaurants have taken advantage of the youth subminimum, even though 73 percent of the sampled restaurants paid a starting wage of less than \$3.80 before the new minimum wage took effect. The survey also explores reasons why employers have not been using the new youth subminimum.

The second topic concerns the effect of changes in the minimum wage on the wage structure. Many fast food restaurants in Texas responded to the minimum wage increase by increasing starting pay from \$3.35 to \$3.80. What did these restaurants do to the compensation of workers whose wage had previously risen to between \$3.35 and \$3.80? Using our survey data, we find that 44 percent of employers in this situation increased the wage of these workers by more than necessary to satisfy the new minimum wage. One interpretation of this finding is that employers are willing to pay extra compensation to preserve the hierarchy in their wage structure that existed prior to the minimum wage increase.

In addition, we find that firms that were constrained by the minimum wage increased their starting wage by 40 cents per hour, while those that were unconstrained (e.g., offered \$3.80 or more) increased their starting wage by an average 20 cents per hour. This finding parallels Grossman's (1983) finding that an increase in the minimum wage induces a wage increase for workers in jobs that pay slightly more than the minimum wage. On the

other hand, it might also be due to a general rise in wages in Texas. In either case, the recent increase in the minimum wage has compressed the distribution of starting wages across fast food restaurants. In particular, the effect of the local unemployment rate and company ownership on wages is attenuated after the minimum wage increase. Furthermore, the coefficient of variation of starting wages declined by nearly one-third after the minimum wage increased.

The final topic examined in this paper concerns nonwage offsets induced by the minimum wage. Our survey reveals no evidence that, compared to restaurants that were already paying at least the new minimum wage, restaurants that were forced to raise their starting wage by the new minimum wage were more likely to cut fringe benefits, cut workers on a shift, or cut the number of shifts.

II. The Minimum Wage Increase of 1990 and the Wage Structure

To describe the impact of recent changes in the minimum wage on the wage structure, we first analyze CPS data for April to August 1989, and for April to August 1990, the most recent months for which data are available at this writing. We restrict the sample to workers who are between age 16 and 21 and who live in the 25 states that did not have a state minimum wage exceeding \$3.35 per hour on April 1, 1990.²

Figure 1 contains a histogram of the wage distribution for workers aged 16-19 in 1989, and Figure 2 contains a histogram for workers in the same age

²The 25 states are: Alabama, Arizona, Arkansas, Colorado, Florida, Georgia, Indiana, Kansas, Kentucky, Louisiana, Michigan, Mississippi, Missouri, Nebraska, Nevada, New Jersey, New Mexico, North Carolina, Ohio, South Carolina, Tennessee, Texas, Virginia, West Virginia, and Wyoming. For details on state minimum wage laws see BNA (1990).

group in 1990.³ It is quite apparent that since the new minimum wage law took effect the spike in the wage distribution at \$3.35 has declined, and a new spike at \$3.80 has emerged. In fact, between 1989 and 1990 the share of workers earning within \$0.05 of \$3.35 an hour fell from 17.4 to 4.1 percent, while the share earning within a similar window of \$3.80 increased from 5.6 to 15.9 percent.

Because employers are permitted to pay a subminimum wage between \$3.35 and \$3.80 only to workers under age 20, we can investigate whether this new provision is being used by comparing the change in the share of workers earning \$3.35 or more but less than \$3.80 between 1989 and 1990 for potentially eligible workers (those age 16-19) and for ineligible workers (those age 20-21). The following tabulation shows the percent of workers in the subminimum-wage range (with standard errors in parentheses), before and after the new subminimum took effect, by age group:

	<u>1989</u>	<u>1990</u>	<u>Change 1990-1989</u>
Age 16-19	33.4% (1.2)	10.5% (0.8)	-22.9% (1.4)
Age 20-21	17.0% (0.9)	4.2% (0.5)	-12.8% (1.1)

The share of workers in the range (\$3.35-\$3.80] fell substantially for both workers who were eligible for the subminimum wage and for those who were not. Moreover, the share fell by an even greater amount for those who, on the basis of their age, were eligible to be paid a subminimum, suggesting

³The wage rate is the hourly wage for hourly rated workers, and the ratio of the usual weekly wage to usual weekly hours for salaried workers.

that the youth subminimum is not being used. These numbers are somewhat difficult to interpret, however, because the CPS files we are using lack job tenure information, which is necessary to determine whether workers in the eligible age group are actually new employees who could be paid the new subminimum. Furthermore, the comparison of 16-19 year olds with 20-21 year olds may not be appropriate here because relatively few of the 20-21 year olds are in the \$3.35-\$3.80 range, so the maximum decline in this earnings group is 17 percent. These ambiguities suggest the need for a more direct approach to estimate utilization of the youth subminimum wage.

III. Survey Design

To more directly study the impact of recent changes in the minimum wage on a labor market where we would expect the minimum wage to have a large impact, we conducted a survey of fast food restaurants in Texas. We selected Texas because it is a low-wage state that does not have a state minimum wage law that would override the FLSA.⁴ Moreover, the fast food industry is a low-wage industry that has lobbied against increases in the minimum wage and has been a staunch supporter of a subminimum wage for youths (BNA, 1985). And the fact that the fast food industry has extremely high turnover (estimated as high as 300 percent per year [BNA, 1985]), and hires many first-time workers makes it more likely that fast food restaurants can take advantage of the youth subminimum.⁵

⁴The state minimum wage in Texas is \$3.35 per hour, and there is no provision for a subminimum. Therefore, the Texas state minimum wage law is irrelevant for jobs that are covered by the federal minimum wage.

⁵Indeed, Love (1986) estimates that 1 in 15 workers obtained their first job from McDonalds! Although we're not sure whether this estimate is accurate, it must undoubtedly be the case that many young workers obtain

We designed a questionnaire to collect retrospective (pre-minimum wage increase) and current information on starting wages, as well as information on the utilization of the new subminimum wage and on nonwage responses to the minimum wage. A copy of the questionnaire, containing tabulations of responses to each question, is provided in the Appendix.

The survey was conducted as follows. We first collected the phone numbers of every Burger King, Wendy's, and Kentucky Fried Chicken restaurant listed in the 1990 Yellow Pages of the metropolitan phone books for Texas.⁶ We then drew a systematic sample consisting of every other phone number listed in the Yellow Pages. After deleting duplicate numbers, disconnected numbers, and wrong numbers, this yielded a universe of 294 potential observations.⁷ We then attempted to interview the manager or assistant manager of these restaurants by phone between December 12 and December 18, 1990. If a restaurant did not respond on the first call, we called back as many as two more times to try to elicit a response.

We obtained a total of 167 responses, for a response rate of 57 percent. Although there may be some concern about possible differences between respondents and nonrespondents, our tabulations did not reveal any systematic differences between restaurants that responded on the first call and those that required at least one follow-up phone call before responding. Finally,

their first job in the fast food industry.

⁶Burger King, Kentucky Fried Chicken and Wendy's are the second, third and fourth largest restaurant chains nationwide. We initially intended to also include McDonald's, the nation's largest chain. But because none of the McDonald's restaurants would respond to our pre-test survey we dropped them from our sample.

⁷Of the restaurants listed in the phone book, 25 were disconnected, and 10 were wrong numbers.

we added further information about the local labor market in which each restaurant is located (e.g., the unemployment rate) using data from the County and City Data Book, 1988.

IV. Survey Results

Table 1 cross-tabulates the starting wage for part-time workers of sampled restaurants before and after the minimum wage increase.⁸ The table indicates that 72.5 percent of the restaurants in our sample were compelled to increase their starting wage by the rise in the minimum wage. Furthermore, one-third of the restaurants moved their starting wage from exactly the old minimum to exactly the new minimum.⁹ From these tabulations, it is clear that the survey has identified a universe of employers that is likely to be affected by the minimum wage, and that has potential to use the youth subminimum.

A. Utilization of the Youth Subminimum Wage

Table 2 reports a variety of survey results breaking the sample into two groups: those paying a starting wage below \$3.80 and those paying above \$3.80 prior to the minimum wage increase last April. Only 1.8 percent of the restaurants in our sample reported that they have used the youth subminimum. Of the restaurants that paid newly-hired part-time workers less than the new minimum wage, 3 percent utilized the youth subminimum. Finally, if we limit

⁸We focus on part-time workers because over two-thirds of fast food workers are part-time workers, and because we have more complete wage data for part-time jobs.

⁹The 8 restaurants that initially paid \$3.35 and increased their wage above \$3.80 all paid exactly \$3.85. And some of the managers of these restaurants maintained that the new minimum was \$3.85, not \$3.80.

the sample to franchisee-owned restaurants that previously started workers at less than \$3.80, the fraction of restaurants using the youth subminimum is 4 percent. (In contrast, none of the company-owned restaurants in the sample utilized the subminimum.) These figures suggest that even in a low-wage industry in a low-wage labor market hardly any employers are using the youth subminimum.

Why are fast food employers so reluctant to use the youth subminimum? Our survey elicited several possible explanations. Perhaps most important, 83 percent of restaurant managers reported that they believed they could not attract qualified teenage workers at a subminimum. This figure declines only slightly, to 78 percent, when we limit the sample to restaurants that previously paid workers less than \$3.80 to start. Thus, a large fraction of managers appear to believe that the increase in the minimum wage coincided with an increase in workers' reservation wages.

Nevertheless, nearly 20 percent of managers who were not utilizing the subminimum reported they could attract qualified workers at a subminimum wage. About half of those who thought they could attract qualified workers for less than \$3.80 reported that they did not know about the new subminimum wage option. Although it seems plausible that store managers or even small franchisees might be unaware of the subminimum wage amendments, it seems implausible to us that company-owned restaurants fail to use the subminimum because of lack of information. Three other reasons were frequently given for not using the subminimum wage: (1) managers believed it wasn't fair to pay a subminimum wage to some workers; (2) the restaurant did not employ teenage workers; (3) the manager believed the law was administratively difficult to apply.

Perhaps our finding of a low take-up rate for the youth subminimum wage should not be surprising in light of Freeman, Gray, and Ichniowski's (1981) finding that only 3% of students' work hours were covered by the subminimum wage permitted for full-time students in the late 1970s. However, the new youth subminimum wage is much easier to use than the full-time student exemption. Notably, the youth subminimum applies to all teenage workers (not just full-time students), and carries less cumbersome restrictions on the hours of employees that can be covered by the subminimum. In spite of its advantages for employers vis-a-vis the full-time student subminimum wage, utilization of the new youth subminimum wage appears to be quite rare. Thus, it is unlikely that the youth subminimum wage will have an important impact on the training of young workers.

B. Wage Compression and the Minimum Wage

Table 2 shows that between April and December of 1990 the restaurants that were required to increase their starting wage by the minimum wage hike increased their starting wage by 12.2% (42 cents) on average, while those who were already above the new minimum wage increased their starting wage by 4.8% (19 cents) on average. There are two potential explanations for why firms that were already paying above the new minimum wage increased their starting wage after the minimum wage increased. First, as Grossman (1983) and Akerlof and Yellen (1990) contend, relative wages may influence work effort so firms already above the minimum wage may adjust their wages to maintain effort levels. Second, a more neoclassical explanation is that market forces would have led to an increase in wages in the fast food industry in Texas even in

the absence of the minimum wage increase.¹⁰

Nevertheless, the increase in the minimum wage led to a substantial reduction in the dispersion of starting wages across restaurants. For example, the coefficient of variation of starting pay for part-time workers decreased by a third, from .074 to .049.¹¹ The between-restaurant reduction in dispersion is also evident from the wage regressions reported in Table 3.¹² For example, the regressions show that company-owned restaurants pay more to start than franchisee-owned restaurants (see also Krueger, 1991), and that restaurants in areas with a higher unemployment rate have lower wages. However, both of these effects are roughly halved after the increase in the minimum wage.

Perhaps of more interest is information gathered by the survey on within firm wage policy in response to the increase in the minimum wage. In particular, suppose a firm originally paid \$3.35 per hour to new workers and then increased its starting wage to \$3.80. What did such a firm do to the pay of incumbent workers whose wages had risen to a rate of say \$3.50? The survey found that 44 percent of firms in this situation increased the wage of the worker earning \$3.50 to above \$3.80, and thus maintained its wage

¹⁰We note, however, that the case for market forces is weakened because the quarterly unemployment rate in Texas was relatively stable throughout 1990, hovering around 6.1 percent. Furthermore, the U.S. average wage in manufacturing increased by only 2.6 percent between April and December, 1990.

¹¹We also found that wage dispersion fell substantially in our CPS samples following the increase in the minimum wage. For example, the coefficient of variation in hourly wages for 16-19 year olds fell from 0.56 in April-August of 1989 to 0.40 in April-August of 1990.

¹²We note that the sample of restaurants used in the regressions is slightly different before and after the minimum wage increase. However, the results are not qualitatively changed if we estimate the regressions on a consistent set of restaurants.

hierarchy. Of all restaurants that were initially paying less than \$3.80 to new hires, 40 percent maintained their wage hierarchy, and the remainder compressed whatever wage differentials existed between long-service workers and new hires.

A related issue is whether firms delay the time until workers receive their first pay raise or reduce the amount of the first raise in response to an increase in the minimum wage. Rows 5 and 6 of Table 2 provide some information on these questions. First, it is clear that the restaurants that were forced to increase their starting wage by the rise in the minimum wage are more likely to delay the first raise they give to workers, and to reduce the amount of the first raise. On the other hand, 85 percent of restaurants that were forced to increase their starting wage did not change either the amount of or time until the first pay raise. If wage growth mirrors productivity growth because of on-the-job training, this result suggests that training was not adversely affected by the higher minimum wage in the majority of fast food restaurants.

C. Nonwage Responses to the Minimum Wage Increase

The final issue we consider is the extent to which fast-food restaurants offset increased labor costs caused by the higher minimum wage by reducing fringe benefits or employment. The results presented in lines 7, 8, and 9 of Table 2 indicate that less than one-fifth of the restaurants reported that they cut fringe benefits and a similar fraction reported that they cut employment, despite the fact that over 70 percent of these firms were constrained to increase their starting wages because of the minimum wage increase. One further striking finding from the table is that there appears

to be little difference in these nonwage responses between those directly constrained by the new minimum wage and those paying starting wages above \$3.80 prior to April 1, 1990. In summary, fully 73 percent of firms that were forced to increase pay to satisfy the new minimum wage did not report cutting employees, shifts, or fringe benefits to cushion their mandated wage increase.

V. Conclusion

Several tentative conclusions can be drawn from our analysis. First, it appears that few employers have elected to use the new youth subminimum wage, even in an industry where many employers could probably readily attract teenage workers at a subminimum wage. Second, we have found evidence that a sizeable minority of fast food restaurants increased wages for workers by an amount exceeding that necessary to comply with the higher minimum wage. In other words, many employers appear to pay a wage premium in order to maintain their internal wage hierarchy. Finally, the majority of fast food restaurants in Texas that were directly affected by the minimum wage increase did not report that they attempted to offset their mandated wage increase by cutting fringe benefits, reducing employment, reducing the amount of workers' first pay raise, or delaying the time until workers' first pay raise.

This behavior seems difficult to explain with the standard model that economists use to evaluate the impact of a minimum wage. On the other hand, it may be more consistent with models of wage determination that emphasize relative compensation, horizontal equity, and effort incentives.

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Figure 1
Histogram of Hourly Wage Rate
16-19 Year Olds, April-August 1989

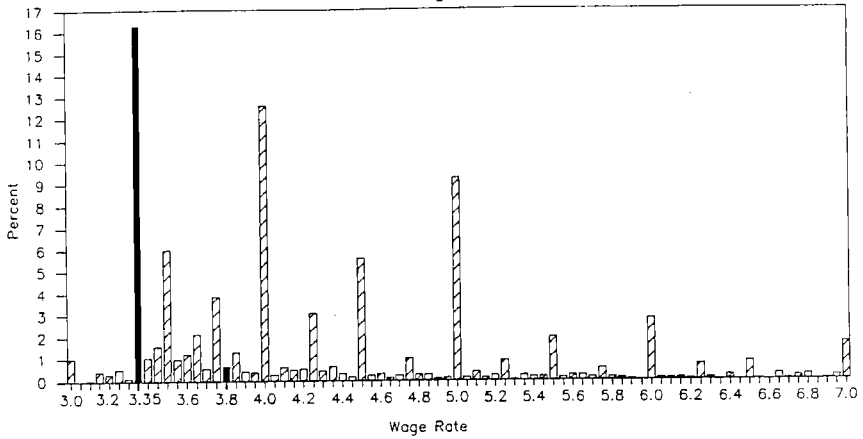


Figure 2
Histogram of Hourly Wage Rate
16-19 Year Olds, April-August 1990

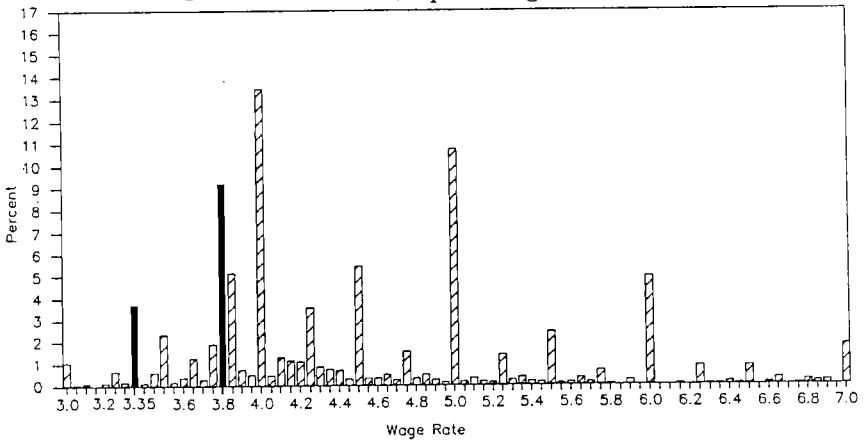


Table 1: Cross-tabulation of Starting Wage for Part-time Employees Before and After Minimum Wage Increase

Wage Before April 1990	Wage in December, 1990		Row Total
	\$3.80	>\$3.80	
\$3.35	52 (32.5%)	8 (5.0%)	60 (37.5%)
(\$3.35, \$3.80)	23 (14.4%)	33 (20.6%)	56 (35.0%)
\$3.80	2 (1.3%)	10 (6.3%)	12 (7.5%)
> \$3.80	0 (0%)	32 (20.0%)	32 (20.0%)
Column Total	77 (48.1%)	83 (51.9)	160 (100%)

Note: Table gives the number of restaurants in each cell, with the percent of the total underneath in parentheses. Data are from the authors' survey of fast food restaurants in Texas.

Table 2: Responses to Change in Minimum Wage by Whether Starting Wage was Above or Below New Minimum Wage on April 1, 1990

	(1) Starting Pay for Part-Time Workers < \$3.80 prior to April 1, 1990	(2) Starting Pay for Part-Time Workers ≥ \$3.80 prior to April 1, 1990	(3) t-statistic for Difference (1) - (2)
1. Proportion using the youth subminimum	0.03	0.00	1.07
2. Average Starting Wage before April 1, 1990	\$3.43	\$3.95	-22.26
3. Increase in starting pay from April 1 to December 1990	\$0.42	\$0.19	10.53
4. Proportion maintaining wage hierarchy ^a	0.41	NA	NA
5. Proportion decreasing amount of first pay raise	0.13	0.00	1.92
6. Proportion increasing time to first pay raise	0.04	0.00	0.97
7. Proportion that cut fringe benefits	0.11	0.19	-1.32
8. Proportion that reduced workers on a shift	0.18	0.16	0.10
9. Proportion that reduced shifts per day	0.08	0.10	-0.32
10. Sample size	116	44	--

Notes:

a. Proportion maintaining the wage hierarchy is the proportion of restaurants that after April 1, 1990 paid a wage above the restaurant's new starting wage to workers who prior to April 1, 1990 had earned between the restaurant's starting wage and \$3.80. See question 4 on the questionnaire in the Appendix.

Table 3: Log Wage Equations for Starting Wages Before and After the New Minimum Wage

Variable	Starting Wage Prior to April 1, 1990		Starting Wage in December 1990	
	(1) Part-Time	(2) Full-Time	(3) Part-Time	(4) Full-Time
Intercept	1.241 (0.091)	1.147 (0.123)	1.374 (0.064)	1.381 (0.077)
Company Owned (1=Yes)	0.038 (0.013)	0.032 (0.017)	0.020 (0.009)	0.022 (0.010)
Wendy's (1=Yes)	0.025 (0.014)	0.018 (0.018)	0.016 (0.010)	0.009 (0.012)
Kentucky Fried Chicken (1=Yes)	0.055 (0.017)	0.057 (0.022)	0.020 (0.012)	0.010 (0.014)
Log Number of Employees	-0.001 (0.018)	0.023 (0.023)	-0.013 (0.013)	-0.009 (0.014)
City Unemp. Rate in 1986	-0.535 (0.206)	-0.679 (0.247)	-0.139 (0.146)	-0.373 (0.157)
Log Population of City in 1986	0.003 (0.005)	0.006 (0.007)	0.002 (0.004)	0.003 (0.004)
R ²	0.292	0.280	0.168	0.191
S.E. of Regression	0.061	0.062	0.044	0.040
Sample size	134	93	136	94

Note: Standard errors are shown in parentheses.

No. of calls

1 115
2 42
3 10

Appendix
Minimum Wage Survey Form
(with Mean Values)

BK 74
KFC 53
Wendy's 40

Phone No. _____ Restaurant Location _____

Date _____ Interviewer _____ Chain _____

Hello, may I please speak with the manager or assistant manager. My name is _____, and I am conducting a survey for researchers at Princeton University on the impact of the Minimum Wage. The survey will just take a few minutes for your time, and your answers will be kept strictly confidential.

1. How many full- and part-time workers are employed at your restaurant?

a. Full-time: 6.91

b. Part-time: 15.41

Read aloud: On April 1, 1990 the minimum wage increased from \$3.35 per hour to \$3.80 per hour.

2. What is the average starting pay rate for nonmanagement employees at your restaurant today?

a. Part-time: \$ 3.93 per hour

b. Full-time: \$ 3.96 per hour

3. What was the average starting pay rate for nonmanagement employees just before the minimum wage increased last April?

a. Part-time: \$ 3.57 per hour

b. Full-time: \$ 3.62 per hour

4. If the answer to 3a. or 3b. is less than \$3.80 ask: If you had a worker who was paid between \$3.35 and \$3.80 per hour before the minimum wage increase -- for example, if someone earned \$3.50 in June 1990 -- did you pay that worker exactly \$3.80 after the minimum wage increase, or did you pay that worker more than \$3.80 per hour?

a. Part-time: Exactly 3.80 _____ How much more than 3.80? _____

b. Full-time: Exactly 3.80 _____ How much more than 3.80? _____

5. After how many weeks does a new worker typically get his or her first wage increase?

15.8 weeks

6. Has the length of time until a first pay increase or the amount of the increase changed since the minimum wage increased?

Amount 10% (Yes=1) Time 3% (Yes=1)

7. The amendments to the minimum wage law that took effect on April 1st allow employers to pay a subminimum wage to workers under age 20 if they receive some on-the-job training. Have you taken advantage of this provision in the law and paid any teenage workers a subminimum wage?

N=3 Yes N=167 No

7A. If No, why not?

- a. Did not know about the law. N=56 d. Unfair N=29
b. Too difficult to apply. N=12
c. Other: N=23

7B. If No, do you think you could attract qualified teenage workers at a subminimum wage?

N=26 Yes N=123 No
(17.5%) (82.5%)

7C. If Yes, approximately how many workers have been paid a subminimum wage, and how much did you pay them? Has additional training been provided to workers getting the subminimum?

8. Did you reduce fringe benefits such as free meals or vacation days to cope with the higher minimum wage?

N=20 Yes N=131 No
(13.3%) (86.7%)

9. Did you cut back on the number of nonmanagement workers on a shift or cut the number of shifts per day to cope with the higher minimum wage?

Reduced nonmanagement workers on a shift N=25 Yes N=126 No
Reduced number of shifts per day N=12 Yes N=139 No

10. Is your restaurant a company-owned unit or a franchised unit?

N=75 Company Owned N=89 Franchised Unit
(45.7%) (54.3%)