Paper discussion 2 – Minimum wages

In last week’s lecture, we discussed the impact of introducing a minimum wage on the labor market equilibrium. Furthermore, the results of our in-class experiment confirmed that in a small market with basically perfect information and no costs of changing jobs (as in perfect competition), introducing a binding minimum wage leads to higher wages but involuntary unemployment.

In this week’s practice session, we will discuss approaches to empirically test the effect of minimum wages. As preparation (also for the exam!), please read the well-known paper by Card and Krueger, “Minimum wages and employment: A case study of the fast-food industry in New Jersey and Pennsylvania” (published in 1994 in the American Economic Review), provided on Campus Online. Additionally, please look at pages 124 to 129 of the Borjas textbook (I also put these pages online).

For the discussion in class, please be prepared to say something on the following questions:

1. Imagine we want to estimate the effect of minimum wages on employment empirically. We observe that minimum wage regulations vary across states in the US (some states have higher minimum wage regulations than others). If we have a database containing all the information about minimum wages and labor force participation rates for the different states, could we obtain estimates for the effect of minimum wages on employment by running an OLS regression of LFP rates on minimum wages? Why or why not?

2. David Card and Alan Krueger tried to evaluate the impact of minimum wages differently. Which empirical strategy are they using to identify the causal effect and why?

3. What are the reasons for Card and Krueger to concentrate on the fast-food industry?

4. How does the main regression specification look like?

5. What are the main findings? Are they similar to previous studies on this topic? Are they in line with the theory?

6. How do the authors check the robustness of their findings?
7. One robustness check Card and Krueger did not use is the so-called “placebo experiment”. This test applies exactly the same methodology for a different period of time in which there was no treatment at all. What results would we expect to obtain by such a test and how does this strengthen the credibility of the main analysis?

8. In chapter 3 of the class’ textbook, Borjas discusses the results of the Card and Krueger paper. Does he seemed convinced or doubtful? Why?

9. What potential reasons does Borjas provide for differences between the traditional minimum wage estimates and the new ones coming from case studies?

10. Borjas also discusses the effectiveness of minimum wages as a measure to combat poverty. What is his opinion and how does he support it?

11. Finally, compare the effectiveness of the minimum wage and the EITC to lift people (and especially families) out of poverty. What are the advantages and disadvantages of each measure?