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Understanding "Wage Theft"

Evasion and Avoidance Responses to Minimum Wage Increases

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An understanding of employers' compliance with minimum wage regulation is crucial for developing a holistic assessment of its labor market effects. Despite its importance, compliance with minimum wage regulation has not been well studied by economists. We investigate two key issues regarding the magnitude and determinants of sub–minimum wage payment, which can indicate noncompliance. First, we estimate the extent of sub–minimum wage payment on the margin. That is, we estimate the increase in sub–minimum wage payment that occurred in response to recent increases in minimum wages. Second, we investigate whether changes in the prevalence of sub–minimum wage payment were shaped by enforcement provisions in state labor laws.

We find strong evidence that higher minimum wages increase the prevalence of workers who report being paid wage rates below the minimum wage. We consistently find that increases in self-reported sub–minimum wage payment average between 14 and 22 percent of the wage gains realized following minimum wage increases. These findings suggest that compliance with minimum wage laws is the norm but that sub–minimum wage payment occurs with nontrivial frequency. We also find evidence that enforcement regimes mediate compliance patterns.

Economic models of compliance extend at least as far back as Gary Becker's 1968 analysis of the economics of crime. A familiar application of the Becker framework to financial misdeeds involves purposeful tax evasion. In the tax context, the classic model suggests that the decision to evade is a function primarily of the gains from successful evasion, the probability of detection, and the penalties associated with being caught. A similar dynamic may be at work with firms' decisions to pay sub–minimum wages.

Empirical research on the determinants of minimum wage noncompliance has been limited. In the U.S. context, analyses have found that violation rates are correlated with several of the factors that arise in classic models, including management structures, higher minimum wage rates relative to average wage rates, and firms' ability to pass labor costs onto consumers. Additional research has assessed the role of minimum wage enforcement institutions and found evidence that noncompliance tends to be high when the value of workers' skills is low and when enforcement technologies are weak and that strict enforcement and penalty regimes reduce the prevalence of sub–minimum wage payment.

Our analysis contributes to this research along two key dimensions. First, in the U.S. context there is very little existing analysis of the prevalence of sub–minimum wage payment on the margin. That is, little evidence reveals how the prevalence of sub–minimum wage payment responds to changes in the wage floor. Second, the economics literature has done little to develop evidence on the empirical relevance of enforcement institutions. Our framework focuses on two sets of decisions—namely, whether firms choose to comply with minimum wage laws and whether workers choose to report noncomplying firms.

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Our empirical analysis focuses on recent minimum wage changes enacted from January 1, 2011, to December 31, 2018. After a lull in the years following the Great Recession, many states have legislated and implemented substantial minimum wage increases. This policy environment offers an opportunity to conduct transparent labor market analyses using standard empirical methods.

We begin our analysis with an investigation of whether the prevalence of sub–minimum wage payment rises as the minimum wage rises. We find strong evidence that it does. In our analysis of untipped hourly workers aged 16–25, for example, we find that a $1 increase of the minimum wage predicts, on average, a roughly 27¢ wage gain and a 3.8¢ increase in underpayment. A consistent finding among analysis samples is that increases in measured underpayment average between 14 and 22 percent of realized wage gains. This suggests that compliance is the norm but that avoidance and evasion are nontrivial.

Our preferred calculation of the aggregate implications of sub–minimum wage payment finds that between January 2011 and December 2018, on average across the country, each dollar of minimum wage increase generated an increase in sub–minimum wage payment of roughly $1.3 billion and realized wage gains, among the employed, of roughly $6.1 billion. The increase in sub–minimum wage payment was thus roughly 21 percent of the value of the realized wage gains.

A key feature of U.S. minimum wage enforcement is that the process is largely driven by worker complaints. As observed in the literature, complaint-based processes have important implications for both patterns of evasion and patterns of realized enforcement actions. Most relevant to our analysis, this literature highlights that a worker's incentive to complain depends in part on the complaint's implications for their employment status.

Our empirical analysis finds patterns of sub–minimum wage payment consistent with important roles for the forces emphasized by our conceptual framework. In a cross-sectional analysis, we find that sub–minimum wage payment is most common when minimum wage rates are high and when enforcement provisions are weak.

We conclude by exploring whether enforcement regimes mediate the extent to which minimum wage hikes increase the prevalence of sub–minimum wage payment. We find that increases in sub–minimum wage payment are largest in states with relatively strong enforcement regimes. This is what our model predicts will happen as the minimum wage begins to bind on the value of what workers produce. As the minimum wage crosses this threshold, workers may cease to desire its enforcement. Increases in avoidance and evasion can be large under strong enforcement regimes because evasion is more prevalent under weak enforcement regimes to begin with.

NOTE:

This research brief is based on Jeffrey Clemens and Michael R. Strain, "Understanding 'Wage Theft': Evasion and Avoidance Responses to Minimum Wage Increases," NBER Working Paper no. 26969, April 2020, http://www.nber.org/papers/w26969.