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# A Natural Experiment That Challenged Conventional Economic Theory

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**Annotation:** This article examines the influential study by David Card and Alan Krueger (1994), which investigates the impact of minimum wage increases on employment in the fast food industry. Using a natural experiment created by a policy change in New Jersey and a comparison with Pennsylvania, the authors apply the Difference-in-Differences (DiD) method to estimate causal effects. Contrary to traditional economic theory, the study finds no evidence of employment decline; instead, results suggest a slight increase in employment.

**Keywords**: Minimum wage,employment,Difference-in-Differences (DiD),natural experiment,labor economics,policy evaluation.

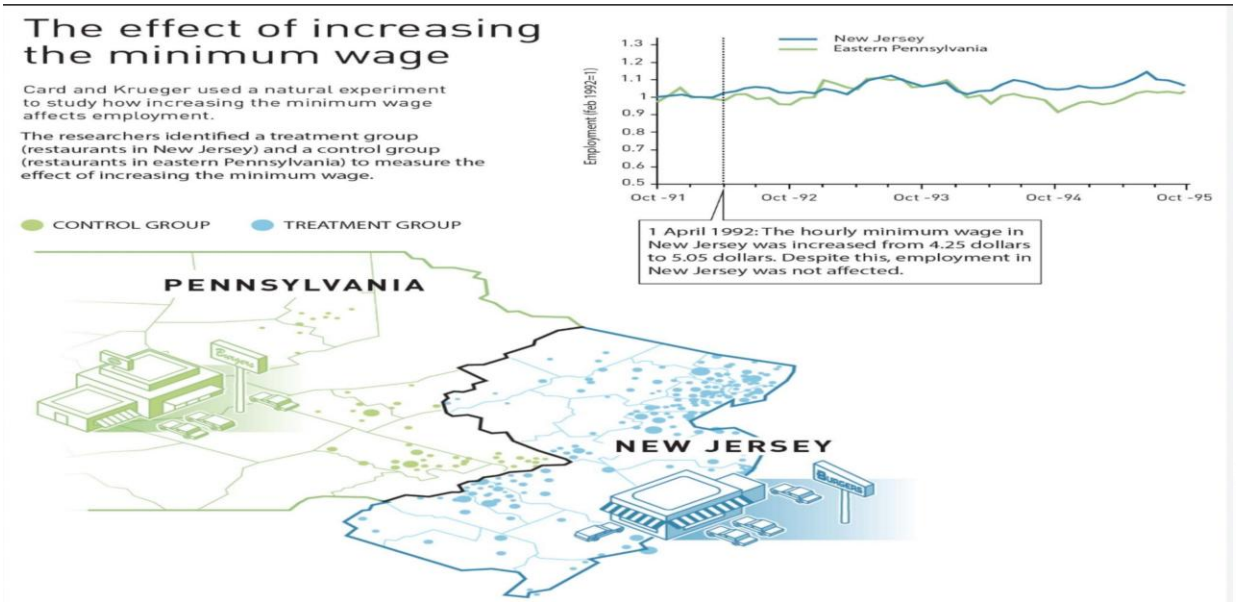
The relationship between minimum wage policies and employment has long been one of the most debated topics in economics. Traditional theory predicts a clear outcome: when wages are pushed above the market equilibrium, firms will hire fewer workers. However, the landmark study by and challenged this conventional wisdom using a simple but powerful empirical strategy.

In 1992, the U.S. state of increased its minimum wage, while neighboring did not. This created a natural experiment: two geographically close and economically similar regions, with one exposed to a policy change and the other serving as a control group.

Card and Krueger collected data from fast food restaurants—such as McDonald's and Burger King—both before and after the policy change. Their goal was to measure how employment responded in the treated state relative to the control state.

To isolate the causal effect of the policy, the authors used the Difference-in-Differences (DiD) approach. This method compares:

- The change in employment in New Jersey (treatment group)
- With the change in employment in Pennsylvania (control group)




By subtracting the general trend affecting both regions, DiD aims to identify the "pure" effect of the minimum wage increase.

Contrary to standard economic predictions, the study found that employment in New Jersey's fast food sector did not decline after the minimum wage increase. In fact, it slightly increased relative to Pennsylvania.

This result was striking. Instead of observing job losses, the data suggested that higher minimum wages might not harm employment—and could even have modest positive effects in certain contexts.

Card and Krueger proposed several explanations for their findings:

1. Monopsony Power

Employers in low-wage labor markets may have some degree of wage-setting power. In such cases, a higher minimum wage can increase both wages and employment.

2. Reduced Turnover

Higher wages may reduce employee turnover, lowering hiring and training costs for firms.

3. Efficiency Wage Effects

Better-paid workers may be more productive, offsetting higher labor costs.

These explanations suggest that real-world labor markets may deviate from the perfectly competitive model often assumed in textbooks.

The study had a profound impact on the field of labor economics:

- It challenged the long-standing consensus on minimum wage effects
- It popularized the use of natural experiments and DiD methods
- It encouraged a wave of empirical research re-examining labor market policies

The work of Card and Krueger is now considered foundational, and it contributed to receiving the Nobel Prize in Economics in 2021.

Despite its influence, the study has not been without criticism. Some economists questioned:

- The reliability of survey-based data
- The representativeness of the fast food sector
- The robustness of the results under alternative datasets

Subsequent research has produced mixed findings, suggesting that the impact of minimum wages may vary depending on context, industry, and labor market conditions.

**Conclusion**

The Card & Krueger (1994) study remains a cornerstone of modern empirical economics. Its key contribution lies not only in its surprising findings but also in its methodological innovation. By demonstrating how real-world data can challenge theoretical assumptions, the study reshaped how economists analyze policy impacts.

Ultimately, the question is no longer whether minimum wages always reduce employment, but under what conditions they might—or might not.

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