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STATE AND LOCAL GOVERNMENTS LEAD THE WAY

Examining the impact of subnational minimum wage increases in the United States

Jacqueline Odum, CAP

Center for American Progress (CAP)

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UNITED STATES

7.4

Unemployment Rate

41.1

GINI

93.2

Wage and salaried workers, total (% of total employed)

68374

GDP per person employed (constant 1990 PPP $)

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Introduction

America's working class families have witnessed a daunting trend over the last 30 years – one marked by wage stagnation and rising costs. Worker productivity rose by nearly 65 percent, yet American workers saw their wages remain stagnant in real terms, and in some cases, even decline.[1] At the same time, the costs of key components to middle class security – such as childcare, higher education, health care, housing, and retirement – have risen, diminishing the prospect of the American dream.[2] This tension between rising costs and wage stagnation is the defining issue of our time. It affects all households, but is a particularly acute concern for low-wage workers, since rising costs are swallowing an increasingly large share of their household income.

Today, 29 states and the District of Columbia have minimum wages above the federal minimum wage. In 2015 alone, 20 states raised their minimum wages, lifting the pay of over 3.1 million workers.

As this chapter will demonstrate, part of the reason for stagnating wages is the declining value of the federal, or national, minimum wage. Because the federal minimum wage has not kept up with inflation, it is worth far less today than in the late 1960s.[3] Moreover, research shows that the declining value of the federal minimum wage continues to contribute to the trend of rising income inequality.[4] Raising the federal minimum wage is a simple and practical policy approach that lawmakers can take to lift wages for workers and combat rising inequality. While the vast majority of Americans support this approach,[5] gridlock on the issue in Congress, the American national legislature, has made federal action almost inconceivable. Amid this inaction,

however, states and localities have taken it upon themselves to implement wage floors above the federal standard.[i]

Today, 29 states and the District of Columbia have minimum wages above the federal minimum wage.[6] In 2015 alone, 20 states raised their minimum wages, lifting the pay of over 3.1 million workers. The District of Columbia's minimum wage is the highest, at US$ 10.50 per hour. Moreover, 10 states have their minimum wage indexed annually to adjust for inflation, and another five states and the District of Columbia plan to follow suit.[7] Cities and counties, too, have begun to set their own minimum wage floors through local ordinances and ballot initiatives. (See **Table 1**.)

Table 1

States with Minimum Wage Floors Above the Federal Standard (US$)

State	Wage	State	Wage	State	Wage
United States	$7.25	Illinois	$8.25	New Mexico	$7.50
Alaska	$8.75	Maine	$7.50	New York	$8.75
Arizona	$8.05	Maryland	$8.25	Ohio*	$8.10/$7.25
Arkansas	$7.50	Massachusetts	$9.00	Oregon	$9.25
California	$9.00	Michigan	$8.15	Rhode Island	$9.00
Colorado	$8.23	Minnesota*	$8.00/$6.50	South Dakota	$8.50
Connecticut	$9.15	Missouri	$7.65	Vermont	$9.15
Delaware	$8.25	Montana*	$8.05/$4.00	Washington	$9.47
D.C.	$10.50	Nebraska	$8.00	West Virginia	$8.00
Florida	$8.05	Nevada*	$8.25/$7.25		
Hawaii	$7.75	New Jersey	$8.38		

* These states differentiate between wage floors on the basis of size of employer and employment benefits offered.

Source: National Conference of State Legislatures, "State Minimum Wages: 2015 Minimum Wage by State," available at http://www.ncsl.org/research/labor-and-employment/state-minimum-wage-chart.aspx#1 (last accessed July 2015).

i Unlike in other countries, the authority to set minimum wages falls with national, state and local authorities. The federal minimum wage acts as an absolute floor, but states are empowered to pass higher minimum wages, and localities can legislate them above the state level if they so choose.

These state and local measures have become an important wage-lifting tool for policymakers. They offer a glimmer of hope for low-wage workers, especially for those residing in areas with a higher cost of living. As minimum wage increases continue to pick up steam on the state and local level, the economic effects of such laws remain highly contentious among both advocates and opponents. This chapter will examine the economic effects of minimum wage increases and provide new analysis while drawing upon existing literature to assess the following:

1. How inadequate minimum wage levels have historically contributed to rising income inequality
2. The impact minimum wage increases have on employment levels
3. The effect that minimum wage increases have on businesses and labor costs

Impact on rising income inequality

For nearly thirty years after World War II, America's working class experienced a period of growing wealth. From 1948 to the mid-1970s, positive trends in hourly compensation mirrored those in growing worker productivity. In the late 1970s, however, these two trends began to diverge as labor productivity growth began to outpace wage growth. The Economic Policy Institute estimates that from 1979 to 2013, worker productivity grew by 64.9 percent.[8] During that same time period, however, hourly compensation of production and nonsupervisory workers, who make up approximately 80 percent of the private sector workforce, grew by a meager 8.2 percent in real terms.[9]

Erosion of the federal minimum wage is one major reason poor households are witnessing the stagnation or even decline of their incomes.

These trends illustrate unprecedented levels of wage stagnation. It should come as no surprise that wage stagnation combined with rising productivity contributes to rising income inequality, which includes other non-wage forms of income. Since 1979, income inequality has risen dramatically. Analysis from the Congressional Budget Office shows that, from 1979 to 2007,

Figure 1

Real minimum wage in 2014 dollars

Source: Author's calculations based on Bureau of Labor Statistics' Consumer Price Index.

inflation-adjusted after-tax income for the top 1 percent of households increased at a rate of 275 percent. In comparison, inflation-adjusted after-tax income increased at a rate of nearly 40 percent for the middle quintile and at a rate of only 18 percent for the bottom 20 percent of households.[10] In other words, while inflation-adjusted income for those at the top of the distribution increased nearly threefold, the vast majority of Americans barely saw their incomes grow.

This growing unevenness in the nation's distribution of income is particularly alarming for low-wage workers, as they often lack access to other non-wage forms of income – such as employer-sponsored healthcare benefits, pensions and capital gains. In fact, wage-related income accounts for the vast majority of total income for those at or near the bottom of the income distribution.[11] Thus, slow hourly wage growth is the major contributing factor to the trend of slow total income growth for the poorest households.[12]

Erosion of the federal minimum wage is one major reason poor households are witnessing the stagnation or even decline of their incomes.

Since 1968, there have been a total 15 legislated increases in the federal minimum wage. Today, the federal minimum wage stands at US$ 7.25 an hour.[13] However, the federal minimum wage has not kept up with inflation, and therefore, has declined in real terms. Had the federal minimum wage kept up with inflation since 1968, it would stand at $10.88 in 2014 dollars.[14]

While an increase in the federal minimum wage would help reverse the trend of rising inequality, it should also be noted that minimum wages are generally not enough to lift families out of poverty.

Research shows that this decline in the real value of the federal minimum wage continues to contribute to the rise in inequality. One way experts measure inequality is by looking at the gap between the median wage and the average wage of those at the bottom 10 percent of the wage distribution – the so-called 50-10 wage gap. According to the Economic Policy Institute, the declining real value of the federal minimum wage between 1979 and 2009 explains more than half (57 percent) of the expansion of the 50-10 wage gap during that time period.[15] Interestingly, the erosion of the federal minimum wage explains almost two-thirds (65.5 percent) of the 50-10 wage gap expansion among female workers but only a tenth (11.3 percent) of the expansion for male workers.[16] This is due, in part, to the fact that two-thirds of minimum wage workers are women, so the erosion in its value has a greater effect on inequality where female workers are concerned.[17]

Within the context of wage inequality, it is important to note that minimum wage increases are not just vehicles for lifting wages for the lowest paid workers. Studies show that minimum wage increases also boost wages for workers that earn slightly above the minimum wage.[18] This ripple effect reduces wage inequality at the lower end of the wage distribution, shrinking the 50-10 wage gap. The positive impact would be felt particularly by women, but also other vulnerable populations that are more likely to be in low-wage work, such as single-parent households and communities of color. In fact, racial minorities represent almost half of potential beneficiaries.[19]

While an increase in the federal minimum wage would help reverse the trend of rising inequality, it should also be noted that minimum wages are generally not enough to lift families out of poverty. This is confirmed by the persistence of poverty in states that provide a minimum wage above the federal standard. Many state-level wage floors fall short of providing living wages

for workers that live in comparatively higher-cost cities. For example, the current minimum wage in California is US$ 9.00 an hour. Hence, today, a full-time, minimum-wage worker in the city of Los Angeles, California makes about $18,720 annually. According to the Massachusetts Institute of Technology's Living Wage Calculator, a family of three – that is, two parents and one child – in Los Angeles needs US$ 58,281 annually to meet minimum standards of living.[20] Thus, the combined salaries of two full-time, minimum-wage workers with one child in Los Angeles falls short by over US$ 20,000.[21] Cities, Los Angeles included, are beginning to address wage stagnation through local ordinances and ballot initiatives that lift the local minimum wage. In 1993, the District of Columbia became the first city to raise its minimum wage, and since then 15 cities have followed suit. Over the last two years alone, 14 cities and four counties have implemented local minimum wage laws of their own.[22] Los Angeles is the most recent example in this series of local policy initiatives. In May 2015, city residents backed a ballot measure that will raise the local minimum wage to US$ 15 over the course of five to six years, depending on the size of the employer.[23]

The analysis generates no clear evidence that minimum wage hikes increase unemployment levels during periods of already high unemployment.

Impact on employment

The effect of minimum wage increases on employment is the subject of a highly contentious debate. Opponents of minimum wage increases often claim that raising the minimum wage increases labor costs, placing a burden on employers that either constrains new job growth or, worse, results in lay-offs. However, a growing body of credible economic research has shown that these claims are unfounded, and that minimum wage increases have no discernible effect on employment levels.[24]

Previous analysis by the Center for American Progress Action Fund (CAPAF) examined the employment effect of minimum wage increases during periods of high unemployment.[25] Lester, Madland and Odum found that, between 1987 and 2012, the majority of states that experienced

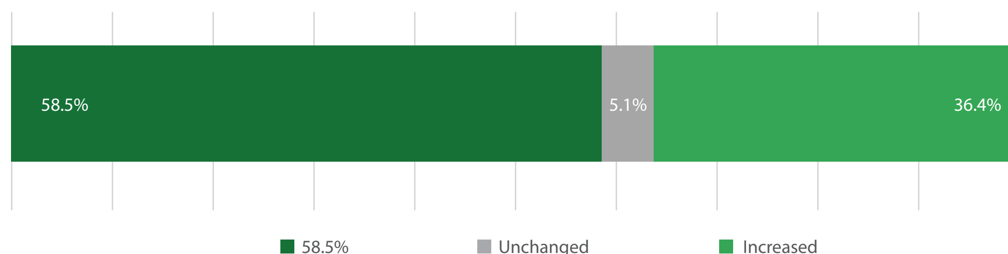
a minimum wage increase during a time of high unemployment saw a decrease in their unemployment rate over the following year.[26] This chapter's analysis replicates the approach used by Lester and his colleagues. The updated analysis includes every effective minimum wage increase for each state and the District of Columbia from 1987 through 2013 at times when the state's (or District's) unemployment rate was at or above 7 percent.[ii] It then examines changes in the unemployment rate over the year following the effective minimum wage increase.

This updated analysis is consistent with previous findings. The analysis generates no clear evidence that minimum wage hikes increase unemployment levels during periods of already high unemployment. Between 1987 and 2013, there were a total of 118 instances in which certain states and the District of Columbia experienced a minimum wage increase in the context of high unemployment. In 69 of these cases, the unemployment rate decreased one year after the effective hike, and in 6 other cases, the unemployment rate remained unchanged. In contrast, the unemployment rate increased for 43 cases. In other words, when the minimum wage was increased during a period of high unemployment, unemployment rates either decreased or remained unchanged 63.6 percent of the time.

Figure 2

Unemployment dropped following a majority of minimum-wage increases

From 1987 through 2013, states raised the minimum wage 118 times when the unemployment rate was at or above 7 percent. Unemployment fell after 58.5 percent of these increases and remained unchanged after 5.1 percent of them.



Source: Authors' analysis of the Bureau of Labor Statistics' Local Area Unemployment Statistics data. Monthly data were averaged to produce quarterly figures.

ii The authors' baseline of 7 percent is based, in part, on the Congressional Budget Office's estimate of the short-term natural rate of unemployment, which peaked at 6 percent in 2012.

Another CAPAF report examined the employment effect of citywide minimum wage hikes.[27] Using a similar approach to that above, the report included every citywide minimum wage increase between 1993, when the first local increase was implemented, and 2013, the last year after which impact can be examined. Because city minimum wage increases are a relatively new trend, only a small number of cities were included in the analysis.[iii] The results showed that in 64 percent of the local minimum wage hikes, local unemployment rates either decreased or remained unchanged.[28]

After controlling for various heterogeneities in employment trends, the authors found that the minimum wage increases had no discernible effect on employment levels.

While we acknowledge that these basic state-and-city-level comparisons do not illustrate causation, these findings offer additional support for a growing consensus among researchers that minimum wage increases have no discernible effect on employment levels.

Rigorous academic studies on state-level minimum-wage hikes support this notion. The latest state-level studies are regarded as some of the most methodologically accurate to date. Unlike older studies, they use quasi-experimental research designs that control for various regional and heterogeneous trends along U.S. Census Bureau divisions.[29] A study published by the Center for Labor Research and Education at the University of California, Berkeley, for example, examined the employment effects for minimum wage increases at state borders. The authors of the study specifically analyzed employment levels of restaurants and other low-wage industries in bordering counties across state lines that had different minimum wage floors. After controlling for various heterogeneities in employment trends, the authors found that the minimum wage increases had no discernible effect on employment levels.[30]

Because citywide minimum wage laws are relatively new, little research exists to measure the full economic effects of local minimum wage increases. However, the literature that does exist offers insightful analysis that supports the general hypothesis championed by proponents.

iii While the state-level analysis controls for periods of high unemployment – unemployment at or above 7 percent – the city-level analysis differs. It does not control for periods of high unemployment because city-level minimum-wage increases are a relatively new trend, and the impact could only be measured in a small number of cities. Controlling for periods of high unemployment in the city-level analysis would have narrowed the number of cases down to a number too small for measurement.

Of the existing city-focused studies, the most rigorous is a paper commissioned by the Institute for Research on Labor and Employment at Cornell University where researchers measured a variety of economic outcomes following San Francisco's 2004 minimum wage increase.[31] The authors found that the city's minimum wage increase had no discernible effect on employment levels in San Francisco. Their analysis on the law's regional employment effects also suggests that the local increase did not negatively affect employment levels in neighboring counties with different minimum wages.[32]

Further, meta-studies reflect a consensus among economists with respect to the general effect minimum wage increases have on employment levels. A meta-study is essentially a "study of studies" that uses statistical methods to compare the results of a large number of separate studies. In a meta-analyses conducted by the Center for Economic and Policy Research (CEPR), economists reviewed the results of the most recent wave of minimum wage studies dating back to the year 2000.[33] The meta-analysis revealed that the majority of existing modern literature showed that minimum wage increases have little to no effect on employment.[34] These findings, coupled with similar meta-studies, signal a growing consensus view among experts that clash with that of minimum wage opponents.

Impact on businesses and labor costs

A common misconception among opponents of minimum wage increases is that they hurt employers. This view is often based on a flawed assumption about the relationship between the minimum wage and labor costs, or the sum of all wages paid to employees. Opponents argue that increases in the minimum wage drive up labor costs, which negatively affect other aspects of business operations, such as costs of goods and services, productivity levels, and hiring and firing decisions. Research, however, dispels this view, suggesting that increases in labor costs for employers are often absorbed by adaptations in the production process.

Historically, increases in labor costs associated with minimum wage hikes have been minimal. For example, of the 10 federally legislated minimum wage hikes since 1989, average increases in labor costs ranged anywhere between a low of 5.3 percent and a high of 9.4 percent.[35] Research suggests that businesses often absorb these

costs through changes in other aspects of production known as "channels of adjustment."[36] These channels include changes in prices, profits, wage compression, the number of hours worked, turnover, worker productivity and performance standards.[37]

Empirical research on how these channels of adjustment absorb the higher labor costs is generally inconclusive or else suggests only small effects. The strongest evidence, however, shows that some of the most important channels for offsetting labor costs actually improve the well being of a firm's workers.[38] Higher wages boost employee morale and reduce absenteeism, thereby increasing levels of worker productivity.[39] In the same way, minimum wage increases can also help to reduce turnover, and with that, costs to the employer associated with recruitment and training.[40]

Higher wages boost employee morale and reduce absenteeism, thereby increasing levels of worker productivity. In the same way, minimum wage increases can also help to reduce turnover, and with that, costs to the employer associated with recruitment and training.

Moroever, the macroeconomic impact of raising the minimum wage can also benefit businesses. In 2013, the Federal Reserve Bank of Chicago estimated that an increase of US$ 1.75 per hour in the federal minimum wage would result in a real GDP increase of 0.3 percent in the short term without any negative effects in the long run.[41] This is because an increase in wages boosts consumer spending. Poorer households tend to spend more of their income than wealthier households, so rebalancing the income distribution has positive effects for aggregate demand.

Taken together, these findings suggest that employers and workers respond to minimum wage increases through several channels of adjustment, thereby minimizing potential negative economic effects. Contrary to popular rhetoric, minimum wage increases are not likely to invoke mass layoffs and substantial price increases within the business community. In fact, the price effect is minimal, with an increase of no more than 0.4 percent to overall prices for a federal minimum wage increase of 10 percent.[42] Rather, both employers and workers are likely to respond to minimum wage increases through a series of changes that will alter the workplace in ways that benefit business owners, working families, and communities as a whole.

Conclusion

Rising costs and wage stagnation have stymied progress in the American economy. Contrary to popular rhetoric, the bulk of empirical evidence suggests that minimum wage increases have positive effects for the economy as whole. This policy measure has the ability to combat rising inequality with little to no effect on employment levels or business costs. State and local lawmakers recognize that minimum wage increases are an effective policy tool for lifting wages and strengthening the economy. Already, 29 U.S. states, or a *majority*, have adopted this policy approach, and in recent years, a growing number of cities and counties have implemented increases of their own. These state and local legislative trends are indicative of a growing need to also raise the federal minimum wage floor. Economic opportunities should not simply be determined by one's place of residence.

As is, the current federal floor stands as a barrier to achieving the American dream. It keeps workers trapped in low-wage work that offers poverty-level wages and an increasing reliance on government transfer programs.

The federal minimum wage floor was meant to allow workers to meet the minimum standards of living; however, in the United States, the federal floor has failed to meet that standard. As is, the current federal floor stands as a barrier to achieving the American dream. It keeps workers trapped in work that offers poverty-level wages and creates an increasing reliance on government transfer programs. Raising this floor would lift the take home pay for millions of workers at or near the bottom of the income distribution.[43] It would give working families a fair chance to secure a middle-class standard of living. Setting a higher federal minimum wage is a simple and practical policy approach to addressing some of the economic disparities of our time.

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