Washington Research Council

Special Report

February 20, 2015 SR 15-01

The Long-Lasting, Negative Consequences of the Minimum Wage

Briefly

- High labor costs hurt a state's economic competitiveness.
- In Washington, these costs include the nation's highest minimum wage.
- Unlike the federal minimum wage, Washington's is indexed to inflation and has no tip credit.
- HB 1355 would increase Washington's minimum wage to $12 in 2019.
- 3.03 percent of Washington's FTE jobs were at the minimum wage in 2012.
- Nationally, workers under 25 are about half of those paid the federal minimum wage.
- Minimum wage increases have long-lasting, negative effects on workers.
- Minimum wages reduce employment for those with fewer skills.
- For each 10 percent increase in the minimum wage, about one-sixth fewer jobs are created.
- Higher minimum wages reduce the earnings of the lowest-skilled.
- Minimum wages do not reduce poverty.
- Minimum wages limit human capital acquisition.
- Minimum wages reduce consumer, employee, and employer choices.

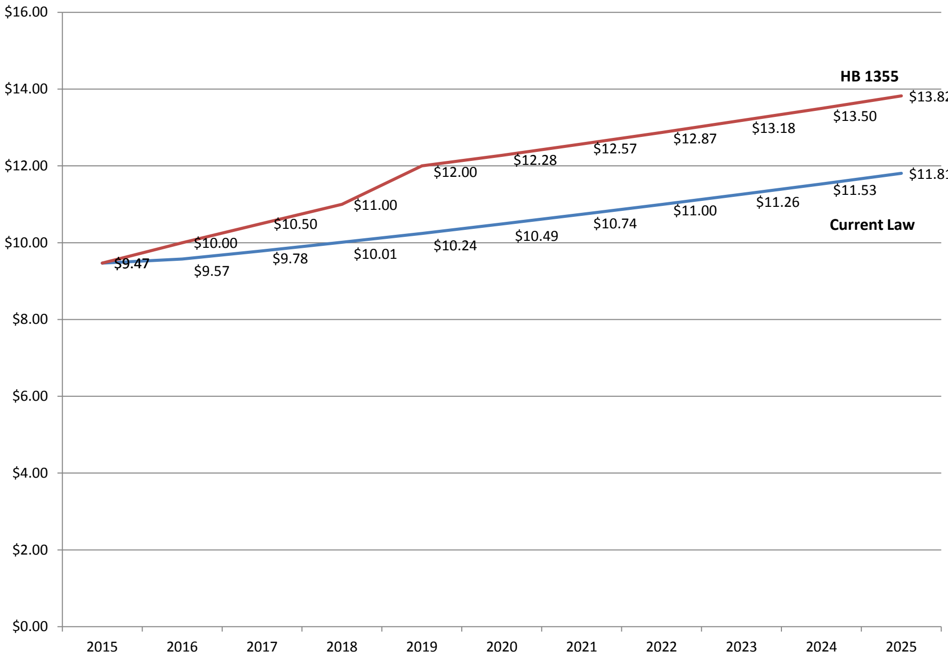
Washington's minimum wage is the highest statewide minimum wage in the nation ($9.47 in 2015). Voters approved Initiative 688 in 1998, indexing the state's minimum wage to inflation—a policy only 10 other states have adopted. Additionally, Washington is one of seven states with no tip credit. (The federal minimum wage is $7.25, with a $2.13 tip credit. That means that for employees that earn tips, employers must provide a minimum cash wage of $2.13 and are responsible for additional wages if the employee's tips do not make up the difference between $2.13 and $7.25.)

Today there is a movement to increase the minimum wage still further, as well as to mandate other employment benefits, like paid sick leave. Voters in the city of SeaTac approved a $15 minimum wage for certain workers (see our 2013 report, "Proposition 1 and the 'Living Wage Movement' in SeaTac: Increasing Unemployment, Decreasing Opportunity"). Additionally, in the city of Seattle, the city council enacted an ordinance that will increase the minimum wage to $15 by 2018 for large employers and by 2021 for small employers.

At the state level, some legislators would like to speed the state's minimum wage increases above their current trajectory. The House Labor and Appropriations committees have passed House Bill 1355, which would increase the state minimum wage to $10 an hour in 2016, $10.50 in 2017, $11 in 2018, and $12 in 2019. Beginning in 2020, the minimum wage would be indexed to inflation. The chart on page 2 compares projections through 2025 of the minimum wage under current law with the minimum wage under the conditions outlined in HB 1355.

In addition, HB 1356, which has also passed out of the House Labor and Appropriations committees, would require paid sick and safe leave for employees of companies with four or more employees. (Safe leave may be taken by employees

Chart: Projections of the Minimum Wage Under Current Law and HB 1355



Source: WRC estimates based on CBO inflation projections

who are survivors of domestic violence, sexual assault or stalking, or it may be taken when the workplace or child's school has been closed for health reasons.) The city of Seattle has required employers to offer paid sick and safe leave since 2012, and Tacoma just passed legislation requiring employers to begin providing paid sick leave in 2016. Nationally, Connecticut is the only state that currently requires paid sick leave, but Massachusetts and California both begin later this year to require paid sick leave. (For more, see our 2012 report, "Labor Costs in Washington.")

Literature Review

A number of economists have evaluated the minimum wage and the minimum wage literature over the years.

In 2008, economists David Neumark and William Wascher* drew four main conclusions from their review: (1) Minimum wages reduce employment for those with fewer skills; (2) Higher minimum wages reduce the earnings of the lowest-skilled; (3) Minimum wages do not reduce poverty; and (4) Minimum wages limit human capital acquisition and have long-term negative impacts on wages.

The bottom line: "Minimum wages do not deliver on their goal of improving the lives of low-wage workers, low-skill individuals, and low-income families" (Neumark and Wascher 2008).

Reduced employment. As Neumark and Wascher note, "the preponderance of evidence supports the view that minimum wages reduce the employment of low-wage workers" (Neumark and Wascher 2008). Proponents of increasing the minimum wage frequently reference David Card and Alan Krueger's 1993 study, which concluded that fast food employment in New Jersey increased relative to Pennsylvania following a minimum wage increase in New Jersey. Card and Krueger based these conclusions on a telephone survey. Neumark and Wascher later re-evaluated New Jersey's minimum wage increase using payroll data and found that employment actually fell.

Indeed, most studies show that minimum wages reduce employment of less-skilled workers. The Congressional Budget Office (CBO) in 2014 estimated that raising the federal minimum wage to $10.10 would reduce employment by 500,000 jobs (CBO 2014). A 2014 study from Jeffrey Clemens and Michael Wither found that

> *Over the late 2000s, the average effective minimum wage rose by 30 percent across the United States. We estimate that these minimum wage increases reduced the national employment-to-population ratio by 0.7 percentage point. (Clemens and Wither 2014)*

In other words, there were fewer jobs per person.

And it isn't just that people lose their jobs, fewer jobs are created. In 2012, Jonathan Meer and Jeremy West found that for each 10 percent increase in the minimum wage, about one-sixth fewer jobs are created: "The most prominent employment effect of minimum wage laws is a decline in the hiring of new employees" (Meer and West 2012). (This

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study utilized data from the U.S. Census Bureau's Business Dynamics Statistics, for the years 1977–2009. The results did not meaningfully change for the 1977–2007 time period.)

Reduced earnings. A higher minimum wage actually "tends to reduce rather than to increase the earnings of the lowest-skilled individuals" (Neumark and Wascher 2008). This occurs because many individuals lose their jobs or are offered fewer hours when the minimum wage increases. Neumark and Wascher write that, overall,

> *low-wage workers experience earnings declines, on average, following an increase in the minimum wage, despite the initial wage increase received by those who stay employed. Although minimum wages bump up wages of these workers, hours reductions, in particular, interact with changes in wages in such a way that earned income declines. (Neumark and Wascher 2008)*

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No net poverty reduction. Instead of reducing poverty, Neumark and Wascher find that minimum wages "primarily redistribute income among low-income families and may increase poverty" (Neumark and Wascher 2008). They find no empirical evidence that minimum wages have beneficial distributional effects. In short, there are winners and losers, and it is hard to say whether one group of low-income workers is more deserving than the other. Further,

> *. . . most economists agree that minimum wages target the poor badly. Even Card and Krueger, whose work on employment effects of minimum wages is frequently cited by minimum wage advocates, acknowledge that "the minimum wage is evidently a 'blunt instrument' for redistributing income to the poorest families." (Neumark and Wascher 2008)*

The minimum wage is not means-tested; it applies to workers regardless of their situation. (The classic example is the teenager with an after-school job who gets a minimum wage raise even though his family is relatively well off.)

Long-term negative impacts. As a result of higher minimum wages, school enrollment rates and completion are reduced. Basically, when the minimum wage is increased, employers are more likely to hire teenagers with more skills (who are more likely to be in school), "with the resulting increase in the relative wages of higher-skilled teenagers inducing some of them to leave school for employment" (Neumark and Wascher 2008). Some research found "that teens and youth exposed to higher minimum wages have lower wages and earnings when they are in their late twenties, consistent with reduced skill acquisition" (Neumark and Wascher 2008).

Clemens and Wither also found lost income effects due to fewer jobs available, an increased likelihood of working without pay (think internships), and slower growth in wages due to lower skilled workers being impeded in gaining experience. Increased minimum wages drive some with some college education to internships, but the less educated to unemployment.

Further, they found "significant declines" in economic mobility: "Minimum wage increases may thus have made the first rung on the earnings ladder more difficult for low-skilled workers to reach" (Clemens and Wither 2014). And, "The estimated reductions in the probability of reaching lower middle class earnings levels are particularly meaningful for low-skilled workers with no college education" (Clemens and Wither 2014).

As we wrote in 2012, "When a wage floor is set, workers who would have been willing to work for less could be shut out of the labor market. Employers may also be less likely to hire additional workers if the cost of hiring them increases" (WRC 2012).

What Does this Mean for Minimum Wage Workers?

Minimum wage jobs are concentrated in

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the accommodation and food services, retail trade, and agricultural sectors (WRC 2014b). Of Washington's full time equivalent jobs, 3.03 percent were at the minimum wage in 2012. (According to the Bureau of Labor Statistics, 4.7 percent of the nation's hourly paid workers earned the federal minimum wage or less in 2012 (BLS 2013).) Of the minimum wage jobs in Washington, 21.9 percent were in King County, but only 1.6 percent of King County's jobs were at the minimum wage. Counties in central Washington, on the other hand, had the highest percentages of minimum wage jobs. (Okanogan County, for example, had the highest at 8.36 percent.) (WRC 2014a)

As the Bureau of Labor Statistics (BLS) notes,

> *Minimum wage workers tend to be young. Although workers under age 25 represented only about one-fifth of hourly paid workers, they made up about half of those paid the federal minimum wage or less. (BLS 2014)*

Minimum wage workers are also less educated:

> *Among hourly paid workers age 16 and older, about 10 percent of those without a high school diploma earned the federal minimum wage or less, compared with about 4 percent of those who had a high school diploma (with no college) and about 2 percent of college graduates. (BLS 2014)*

And they are more likely to work part-time:

> *About 10 percent of part-time workers (persons who usually work fewer than 35 hours per week) were paid the federal minimum wage or less, compared with about 2 percent of full-time workers. (BLS 2014)*

Given the minimum wage's disemployment effects and the prevalence of young people working for the minimum wage, one would expect high teen unemployment. And indeed, in 2013, Washington, with the nation's highest minimum wage, had an overall unemployment rate of 7.0 percent (compared to the national rate of 7.4 percent). But for those aged 16 to 19, Washington's unemployment rate was 30.6 percent (compared to the national rate of 22.9 percent) (WRC 2014c).

The minimum wage is just that—a *minimum* wage. As people gain skills, they tend to earn more, as the BLS numbers indicate. But it isn't *only* teenagers earning the minimum wage. Teenagers will garner more skills and move up the earnings ladder, but what about older low-skilled workers?

Research shows that minimum wages reduce employment, whether through layoffs or reduced hours, or even by suppressing job creation that otherwise might occur. The negative impact on job creation hurts low-skilled workers because they have fewer options—the job not created might have been ideal (or even just marginally better) for an older low-skilled worker in an unhappy situation.

As the minimum wage rises, automation and other alternatives to low-skilled labor become more attractive and cost effective. Indeed, according to Carl Benedikt Frey, an author of a 2013 University of Oxford study on automation, "Half of all jobs—and 70% of low-skill jobs—may be replaced by robots or other technology in 10 to 20 years" (Webster 2014). The economics of replacing labor is already changing:

> *"It's already feasible . . . for a lot of those low-skill jobs to be automated, at least in part," says Brian Points, an economist with [Economic Modeling Specialists Intl.].*
>
> *. . . lower tech costs, the fear of a $15 minimum wage and increased customer expectations are pushing food service companies to adopt tablets for ordering and computerized systems for kitchens and inventory . . . . (Webster 2014)*

Also, when considering the impact of a

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minimum wage increase on a particular person, it's important to consider the effect that a wage increase would have on that person's marginal tax rate and level of government benefits. The interaction may make the person worse off. As CBO wrote in 2012,

> *Under the current system of taxes and government benefit programs, as workers' earnings increase, the amount of taxes they owe typically rises and the amount of cash and other benefits they receive typically falls. The combination of increased taxes on earnings and reduced benefits determines effective marginal tax rates—specifically, the portion of an additional dollar of earnings that is paid in taxes or that is offset by a reduction in benefits. Those effective marginal tax rates affect people's incentives to work. In particular, and all else being equal, people tend to work fewer hours when effective marginal tax rates are high. Such behavioral responses, in turn, affect the overall supply of labor in the economy. (CBO 2012)*

Along these lines, economist Jeffrey Dorfman points out that the proposal to increase the federal minimum wage to $10.10 would actually benefit government coffers more than workers:

> *. . . a hypothetical single mom with one kid would see more than half of the proposed minimum wage increase offset by a reduction in benefits from the federal government and increased taxes. An increase in the minimum wage is great if you keep your job and your family already has too much household income to get welfare benefits, a category of households which is actually quite common. For those actually in or near poverty, however, any gain in wage earnings causes a significant loss in benefits that severely curtails the claimed impact of a minimum wage increase at lifting the working poor out of poverty. Essentially, these workers face the equivalent of a 50 percent or higher tax rate. (Dorfman 2014)*

About the federal proposal, CBO estimated that 900,000 people (on net) would move above the poverty threshold (CBO 2014). (That's 2 percent of the 45 million people projected to be below the threshold under current law.)

Unsurprisingly, CBO also found that the minimum wage is an inefficient tool:

> *To achieve any given increase in the resources of lower-income families would require a greater shift of resources in the economy if done by increasing the minimum wage than if done by increasing the EITC. (CBO 2014)*

Clemens and Wither similarly point to the Earned Income Tax Credit (EITC) as a better alternative:

> *Our estimates provide evidence that binding minimum wage increases reduced the employment, average income, and income growth of low-skilled workers over short- and medium-run time horizons. By contrast, analyses of the EITC have found it to increase both the employment of low-skilled adults and the incomes available to their families (Eissa and Liebman, 1996; Meyer and Rosenbaum, 2001; Eissa and Hoynes, 2006). The EITC has also been found to significantly reduce both inequality (Liebman, 1998) and tax-inclusive poverty metrics, in particular for children (Hoynes, Page, and Stevens, 2006). Evidence on outcomes with long-run implications further suggest that the EITC has tended to have its intended effects. (Clemens and Wither 2014)*

Ultimately, increasing the minimum wage involves a tradeoff—some get higher wages, but some lose their jobs or face long-term negative impacts on earnings and mobility. And workers are also consumers: some of the costs of minimum wage increases are passed on to them in the form of higher prices or fewer consumption choices. Further, using the minimum wage as an anti-poverty tool is plainly ineffective. The older low-skilled worker stuck in a dead-end job would be better served by a more targeted anti-poverty tool.

Impacts on Businesses

One reason that minimum wages are so popular is that they are not a line item in the state or federal budget (except insofar as they apply to government employees). Instead, employers must figure out how to increase wages for their minimum wage employees. In addition to the possibilities noted above (layoffs, reduced hours, diminished job creation), employers might increase prices or—especially in cases when the minimum wage is increased only in certain jurisdictions—they might move jobs to a location with less onerous labor policies. (This effect may be more pronounced in cities along the borders with Idaho and Oregon, which have lower minimum wages.) Also, the benefits to businesses with the flexibility to provide higher wages as a way to reduce worker turnover erode when all businesses must provide the same higher wages.

Here the interaction between numerous employment policies comes into play. Raising the minimum wage may not be the deciding factor in a business relocating and moving its jobs to another area or simply reducing its work force, but if it is one of many relatively high or inflexible labor costs (including mandatory paid sick leave, for example) it may induce these changes.

As Neumark and Wascher point out,

> *. . . the influence of modest changes in the minimum wage on the national economy is undoubtedly small relative to business cycle fluctuations and other macroeconomic shocks. . . . Indeed, minimum wage proponents often argue that aggregate employment rose noticeably in a particular year despite an increase in the minimum wage that year, which may be true but does not speak to the effects of minimum wages. (Neumark and Wascher 2008)*

Thus, the fact that not all businesses close, doesn't mean the minimum wage isn't impactful. Small, local shops and restaurants that people appreciate in their neighborhoods are perhaps most at risk. But so are manufacturing employers who compete with overseas businesses able to employ much lower cost labor.

Following are some recent examples of business responses to minimum wage increases:

- Cascade Designs, a Seattle manufacturer, plans to move 100 jobs to Nevada. Although the company cites the area's expensive real estate as a main reason for the move, that is not the only factor:

  > *. . . labor costs—recently subject to a minimum wage of $15 per hour—also add up, especially as Cascade competes with brands that rely on cheap overseas labor, [spokesman Martin] Maisonpierre said. . . .*
  >
  > *He said the jobs in Reno will pay $10 an hour or more. Many of them will be on the more labor-intensive, less-specialized end of the spectrum. A lot of the more complex, high-tech manufacturing will remain in Seattle, Maisonpierre said. (Gonzalez 2015)*

  A higher minimum wage makes less-specialized jobs more unaffordable for Seattle area employers, but higher end jobs continue relatively unaffected. This ought to concern those worried about income inequality. David Burroughs, the company's Vice Chair,

  > *said Seattle's new minimum wage nudged them into action. Burroughs said, 'We've got competitors that are working at $2 an hour.' . . . He said the $15 an hour minimum wage would eventually add up to a few million dollars a year. (Jaffe 2015)*

- The New York Wage Board recommends increasing the state's minimum cash wage for tipped workers to $7.50 (its minimum wage is currently $8.75) (NYDOL 2015). In light of that possibility, the restaurant industry is considering its options:

> *"We are seriously exploring collecting a service charge from our customers and paying our employees a weekly, merit-based salary," said Jimmy Haber, managing partner of ESquared Hospitality, which owns the BLT restaurant empire. He estimates ESquared's labor costs would increase by $1 million to $1.4 million a year if the current tip credit goes up to $7.50 or $8.50. . . .*
>
> *Most [restaurant owners] agree that they will have to raise their menu prices and reduce their tipped workers' hours, while acknowledging that service could be affected.*
>
> *"Waiters' hours were never on the cutting floor before, but once they become more expensive," said Eric Bromberg, co-owner of Blue Ribbon Restaurants, "you put more focus on that line item." (Fickenscher 2015)*

- Borderlands, a science fiction specialty book store in San Francisco, is closing:

> *In November, San Francisco voters overwhelmingly passed a measure that will increase the minimum wage within the city to $15 per hour by 2018. Although all of us at Borderlands support the concept of a living wage in principal and we believe that it's possible that the new law will be good for San Francisco—Borderlands Books as it exists is not a financially viable business if subject to that minimum wage. Consequently we will be closing our doors no later than March 31st. (Borderlands 2015)*

They cannot increase their prices, but "The change in minimum wage will mean our payroll will increase roughly 39%. That increase will in turn bring up our total operating expenses by 18%" (Borderlands 2015). The owner also writes that his salary was $28,000 in 2014 (about $13 an hour) and notes that at $15 an hour, he could make more working fewer hours for someone else.

As he told the New Yorker,

> *'If people think I'm lighting hundred-dollar cigars with hundred-dollar bills back in the office, it's like, that's not happening,' he said, noting that he usually works fifty or sixty hours a week. (Vara 2015)*

Although the owner supports higher minimum wages, the consequence is that he will no longer be able to hire others or be his own boss. An employer is no longer able to offer employment and employees are no longer able to accept at a price that is satisfactory to both. It's a lesson for other jurisdictions:

> *He said that he wanted to be transparent with his customers, but he also hoped to make the city aware of one consequence of the minimum-wage increase, with the hope that it might compel local lawmakers and the public to more seriously consider the impact on small businesses before passing policies like this in the future. (Vara 2015)*

As shown by these examples, minimum wage increases can lead to decreased employment opportunities for low-skilled workers even if it's not the only factor involved in business decisions. As Megan McArdle writes of the Borderlands Books example,

> *. . . the face of retail in San Francisco is likely to change: It will become more focused on wining and dining the affluent, less focused on providing physical goods to people with more modest incomes. On average, the number of stores may not even fall. But in specific, many will disappear. (McArdle 2015)*

In this way, too, higher minimum wages hurt low-income people by creating an environment that caters less to them and more to those with higher incomes.

Comment

Minimum wages have been consistently shown to reduce employment and mo-

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bility. If the goal is poverty reduction, there are much more efficient and targeted methods. Still, the Legislature is considering a bill that would increase Washington's minimum wage, even though it is already the highest in the nation.

Increases in the minimum wage are a tradeoff. Some gain, but many lose. Those who keep their jobs and their hours benefit. But those employees who lose their jobs or have their hours reduced lose out. Research shows that the negative impacts on individuals and businesses are real and long-lasting. These impacts are made worse by other labor mandates (like paid sick leave) and Washington's generally high business costs. In the end, if Washington businesses and entrepreneurs can't afford to maintain or create jobs, lower-skilled workers on the bottom end of the pay scale are the ones that suffer most.

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