HOW RAISING THE MINIMUM WAGE COULD AFFECT THE ECONOMY

Overview

The legislatively mandated minimum wage is the lowest hourly compensation an employer can pay a worker. Originally, it was introduced in 1938 to prevent factories from exploiting workers by paying them low wages that would keep them in poverty.

It is possible that some of those factories may have gone out of business because they were unable to sustain the higher mandated wage. However, companies with sustainable business models survived the new regulation, and the country thrived after passage of the Fair Labor Standards Act (FLSA).

Today, the federal minimum wage in the United States is $7.25 per hour; for workers whose compensation is partially funded through tips, their minimum wage is $2.13 an hour. However, 29 individual states have established a higher minimum wage, with others scheduled to incrementally increase their state minimum wage over the next several years.[2]

In fact, 42 cities also have passed legislation to increase the minimum wage above the current federal mandate. Among them, 22 are already requiring an hourly wage of $15 or more.[3]

According to a recent poll by Pew Research, two-thirds of Americans, including more than 40% of Republicans, are in favor of increasing the federal minimum wage to $15 an hour.[1]

President Joe Biden has proposed an incremental plan to increase the minimum to $9.50 this year toward the goal of $15 an hour by 2025. However, in light of lost revenues many businesses have experienced due to the pandemic, Biden recently conceded that perhaps the goal could be adjusted to $12 or $13 an hour by 2025. Thereafter, the plan is to index the federal minimum wage to the median U.S. wage, which is the middle point at which half of workers earn more and half earn less.[4]

Proponents of the minimum wage increase say it would be instrumental in reducing poverty, mitigating income inequality and boosting employee morale — which, in turn, could improve productivity. On the other side of the coin, opponents believe a mandated increase would cause higher prices and job losses, thus increasing the number of people living in poverty.

Inflation

There are two sides to the inflation theory. One is that when business owners have to pay their workers more, many believe they must raise the price of their goods and services to pay for the wage hike. However, economists say that wages are only one component of the price equation, and in many cases, heightened wages can be offset by higher morale/productivity and lower turnover costs.

The other side of the inflation theory is that if wages do not keep up with overall increases in the cost of living, more and more workers will likely sink into poverty. Less consumer spending reduces product demand, so companies may lose revenues.

The reality is that today's wages have not kept up with gradual increases in the cost of living over the past decade. In fact, there has never been a lag of 10 years or more before increasing the minimum wage since the Fair Labor Standards Act was passed in 1938.

The last increase was in July of 2009. Since then, general inflation has increased by more than 20%, and the average rent across the country has increased by more than 30%. In short, workers who earn the current minimum wage ($7.25/hour = $15,080/year) can no longer afford a basic one-bedroom apartment (national average $1,470/month x 12 = $17,640/year) — and that's not including utilities, food, transportation and insurance.[5]

Jobs

Many business models, especially small mom-and-pop shops, may not be able to sustain a higher minimum wage — even an incremental increase over several years. According to the Congressional Budget Office (CBO), the current proposal to raise the minimum wage to $15 by 2025 would essentially eliminate 1.4 million jobs due to staff cuts and business closures.

However, the CBO also projects that the mandated wage hike would likely increase the incomes of 17 million people, lifting 900,000 out of poverty. So, while there is never one solution that will benefit everyone, the CBO numbers suggest that the advantages of serving 17 million people outweigh the disadvantages of 1.4 million becoming jobless.[6] And, consider that once the latter cohort does find other jobs, they too will benefit from the higher mandated wage.

Over the past 25 years, evidence-based research such as that established by the CBO has changed the mindset of many economists on this issue of lost jobs. This evolution started with a report published in 1993 when the state of New Jersey raised its minimum wage. The study compared the impact on 410 fast-food restaurants in New Jersey and in Pennsylvania — which did not raise the minimum wage. Despite having to pay higher wages, restaurants in New Jersey actually added more jobs than those in Pennsylvania.

The researchers concluded two reasons why New Jersey restaurateurs expanded: (1) a slight increase in prices did not dissuade patrons, and (2) happier workers were less inclined to quit, so the increased cost was mitigated by lower turnover and training expenses.[7]

"Research has shown that raising the minimum wage reduces poverty and has positive economic benefits for workers, their families, their communities and local businesses where they spend those additional dollars," said Rosemary Boeglin, a White House spokeswoman.[8]

Economic Advantages

Higher wages, particularly among lower-income households, tend to circulate back into the local economy. In fact, small-business owners rely on customers to earn enough income to be able to afford their wares — such as a local eatery, a farmer's market or an auto mechanic shop. A higher minimum wage is likely to increase consumer spending, creating a higher demand for goods and services and, in turn, more jobs. Ultimately, higher wages can be a pro-GDP growth strategy.

Raising the minimum wage also has the potential to decrease government spending. Higher-earning workers get a lifeline out of poverty, which means less reliance on government welfare programs and tax subsidies. According to the Economic Policy Institute (EPI), if the federal hourly minimum wage is increased to $15 by 2025, the federal government would save between $13.4 billion and $31.0 billion on major public assistance programs.

For example, note the savings projected in the following programs:

- Earned income tax credit (EITC) and child tax credit (CTC) — between $6.5 billion and $20.7 billion a year
- Supplemental Nutrition Assistance Program (SNAP) — between $3.3 billion to $5.4 billion a year

Higher wages also lead to increased income taxes. The EPI projects that the $15 an hour minimum wage would raise an additional $7.0 billion to $13.9 billion in annual contributions to Federal Insurance Contributions Act (FICA) tax revenues, which go to support Social Security and Medicare benefits. Another study found that higher minimum wages give workers who are closing in on retirement a good reason to work longer and delay drawing Social Security benefits.

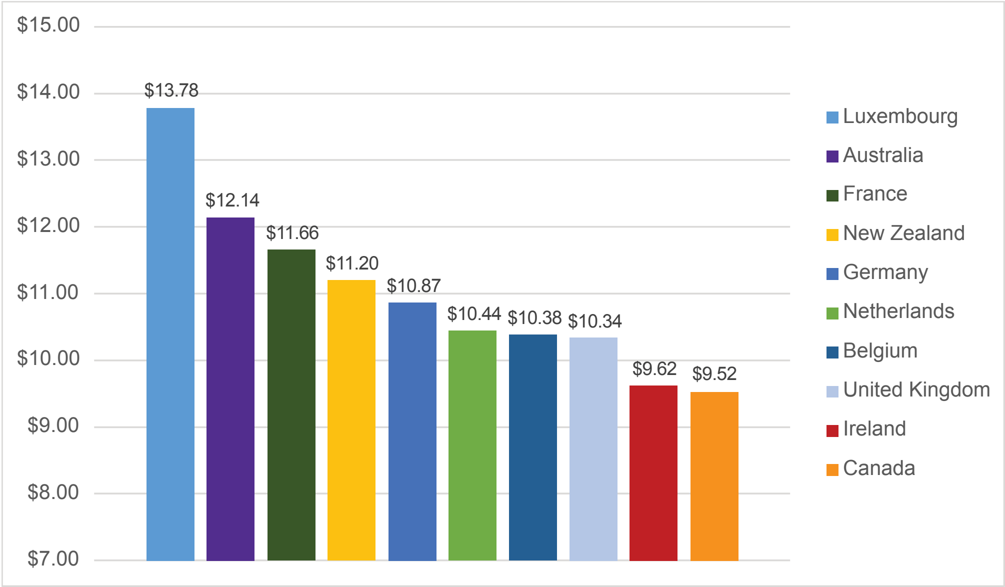
There are even health benefits associated with a higher minimum wage, presumably due to the ability to afford better health care, healthy food choices and more exercise options. A growing body of research correlates higher minimum wages with a lower incidence of smoking, reduced obesity, lower teen birth rates, fewer alcohol-related traffic fatalities, fewer suicides and higher infant birth weight. In turn, these positive health implications allow for reduced spending by Medicaid, Medicare and Veterans Affairs. And, of course, the healthier the national workforce, the longer people can continue working and contributing to income and payroll tax revenues.[9]

"Economists no longer reflexively oppose minimum wages, as most once did. Empirical work assembled over the past three decades has demonstrated that modest increases in the minimum wage typically have, at most, small negative effects on employment."[10]

Global Competitive Landscape

The stronger the U.S. economy, the better we can compete on the national stage. At present, the U.S. lags other developed countries in the mandated minimum wage. Currently, we rank 12th in the world, but perhaps more importantly, the U.S. minimum wage represents 33% of the nation's median earnings. This is last among the 31 countries in the Organization for Economic Cooperation and Development. By comparison, Canada's minimum wage accounts for 51% of median income; France's represents 62%.[11]

Top 10 Countries with the Highest Minimum Wage[12]



Final Thoughts

Clearly, there are advantages and disadvantages to increasing the minimum wage. Given that it has been 12 years since the last change, companies may need to start considering how to accommodate potentially mandated increases as part of their staffing budget. The biggest variables are how much the minimum wage will increase and when.

On one hand, now may not be the ideal time for a large wage increase. After all, on the heels of the pandemic, many businesses lost revenues and would not be able to recover if they were required to pay minimum-wage staff substantially more. It is worth noting, however, that the U.S. has increased the minimum wage during economic declines in the past. Most notably, the original Fair Labor Standards Act was passed following the Great Depression to help get the country back on its feet.

The Wealth Report

Just as businesses must make adjustments for operational expenditures, we should all continually monitor our household budget to identify rising costs. With a pending increase in the minimum wage, we may see higher prices for food, entertainment and other common expenses. Slight increases are not likely to break our budget, but all the same, cutting costs in order to mitigate higher outlays is what balancing a budget and long-term planning are all about.

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[1] The Economist. Jan. 30, 2021. "What would a $15 minimum wage mean for America's economy?" https://www.economist.com/finance-and-economics/2021/01/30/what-would-a-15-minimum-wage-mean-for-americas-economy. Accessed March 29, 2021.
[2] World Population Review. 2021. "Minimum Wage by State 2021." https://worldpopulationreview.com/state-rankings/minimum-wage-by-state. Accessed March 29, 2021.
[3] Paul Wiseman, Dee-Ann Durbin and Christopher Rugaber. PBS. Feb. 17, 2021. "How economists see Biden's $15 wage proposal." https://www.pbs.org/newshour/health/how-economists-see-bidens-15-wage-proposal. Accessed March 29, 2021.
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[11] Paul Wiseman, Dee-Ann Durbin and Christopher Rugaber. PBS. Feb. 17, 2021. "How economists see Biden's $15 wage proposal." https://www.pbs.org/newshour/health/how-economists-see-bidens-15-wage-proposal. Accessed March 29, 2021.
[12] World Population Review. 2021. "Minimum Wage by Country 2021." https://worldpopulationreview.com/country-rankings/minimum-wage-by-country. Accessed March 29, 2021.

spectrum advisors