

## *Increasing the Minimum Wage*

Minimum wage increases have been a popular policy option at both the state and federal levels. Most recently, Congress has debated raising the federal minimum wage from \$5.15 to \$6.15 an hour. Although California's minimum wage is already higher than the federal one, a recent *Los Angeles Times* poll showed that over 80 percent of those questioned favored a new federal increase. The appeal of such an increase relies heavily on two commonly held assumptions: first, that raising the minimum wage would increase income for the poor, and second, that it would impose little public or social cost.

In *Increasing the Minimum Wage: California's Winners and Losers*, Margaret O'Brien-Strain and Thomas MaCurdy test these assumptions by modeling the effects of the 1996 federal increase from \$4.25 to \$5.15 per hour. In particular, the authors pose four questions about that increase and its effects.

- What was the magnitude of the wage increase for workers and employers?
- What share of the additional income went to poor families in California?
- What types of families paid for the higher labor costs incurred as a result of the wage increase?
- How would the answers differ if the minimum wage increase had been a state rather than a federal increase?

Using data from the Survey of Income and Program Participation, the authors calculated the expected additional take-home earnings for workers who previously had made less than \$5.15 an hour. They then evaluated the effects of the wage increase on different types of families. They also estimated the additional costs families pay in the form of higher prices caused by the increase in the minimum wage. For the purposes of their analysis, the authors assumed that an increase in the minimum wage would not result in lost jobs or lower profits. They also assumed that the entire increase in labor costs would be passed on to consumers in the form of higher prices.

### *Key Findings*

- 1. Families living under the poverty line receive only a fraction of the benefits of a minimum wage increase. Even under broader definitions of poverty, poor and near-poor families receive less than half of the additional earnings.**

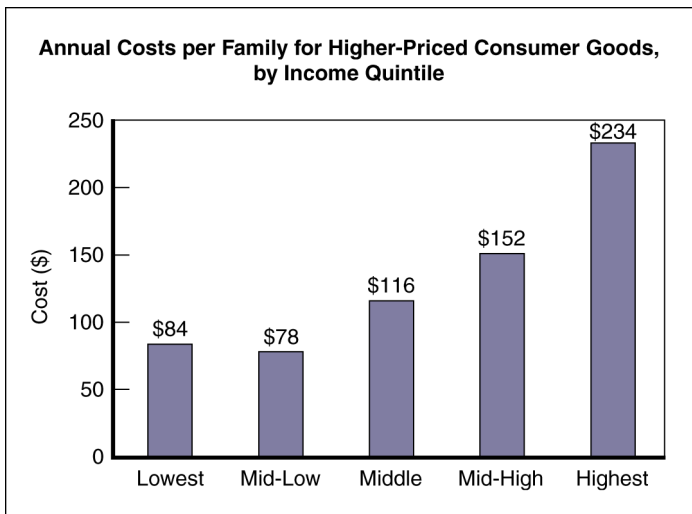
Only 11 percent of the additional earnings from the minimum wage goes to families with children living in poverty. In fact, high-income families are nearly as likely as low-income families to benefit from the minimum wage increase. Families in the bottom 40 percent of the income distribution receive 43 percent of the extra earnings from the increase in the minimum wage, while families in the top 40 percent of that distribution receive 34 percent of the additional earnings.

- 2. As the minimum wage drives up prices, low-income families pay proportionately more than high-income families for the goods they buy.**

If no employment losses follow a minimum wage increase, employers are likely to pass along their higher labor costs as higher prices for the goods they produce. The federal increase from \$4.25 to \$5.15 costs California families an average of \$133 more per year for the goods they normally purchase. Since higher-income families spend more, they would pay more in absolute terms than lower-income families: up to \$234 per year compared to \$84 per year. However, this price increase represents a smaller share of expenditures for higher-income families because fewer of the goods they buy are produced by low-wage workers.

- 3. On balance, the minimum wage increase redistributes income to families with low-wage workers from families without such workers, regardless of their income level.**

About one in five families at all income levels benefits from a minimum wage increase because there is a low-wage worker in the family. If no jobs are lost following such an increase, families with low-wage workers are clearly better



*High-income families would spend more as a result of a higher minimum wage. However, the price increases borne by low-income families represent a larger percentage of their household expenditures.*

off. Although these families lose some of their additional earnings to taxes and higher prices for the goods they purchase, these costs do not offset the extra income from the higher wage. Even at the low end of the income distribution, however, most families do not include a worker who would be affected by a minimum wage increase. Among the poorest 20 percent of families in California, for example, three out of four pay higher prices without receiving any additional income.

**4. Overall, California families are better off with a state-only increase in the minimum wage and worse off with a federal increase.**

Under a federal minimum wage increase, Californians must pay higher prices for goods produced by minimum wage workers both within the state and out of state. Unfortunately, the extra labor costs exceed the extra income that families receive because those earnings are subject to

income and payroll taxes. Under a state-only increase, however, as much as a third of the additional labor costs are paid by out-of-state consumers when they purchase goods exported from California. In the case of a state-only increase, the benefits to Californians exceed the overall costs, even though most families still pay more without receiving higher earnings. However, a state-only wage increase makes goods produced in California relatively more expensive and increases the likelihood that the minimum wage will cause employment losses.

**5. The wage increase from \$4.25 to \$5.15 raised labor costs by approximately \$1.5 billion in California and by \$13 billion nationwide.**

The 1996 federal increase raised the gross earnings of low-wage workers by about \$12 billion in the United States, with \$1.4 billion going to higher wages for Californians. Because of payroll taxes and other factors, however, the total labor costs were higher and the change in take-home pay was lower than the increase in gross earnings. Thus, the increased minimum raised labor costs in California by \$1.53 billion, but workers kept only \$1.11 billion. The remaining \$421 million went to payroll and income taxes collected on the higher wages.

***Conclusions for the Current Policy Debate***

Since the 1996 increase was passed, California increased its own minimum wage to \$5.75, and Congress is now calling for an additional increase to \$6.15. The new increase is likely to have similar distributional effects, with one important exception. Given California's present minimum wage of \$5.75, the new federal minimum would represent a \$1 increase for workers outside of California but only a 40-cent increase for in-state workers. This increase would have the opposite effect of a state-only increase. Families in California would pay more for their goods than they would receive through higher earnings.

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*This research brief summarizes a report by Margaret O'Brien-Strain and Thomas MaCurdy, Increasing the Minimum Wage: California's Winners and Losers (2000, 98 pp., \$10.00, ISBN: 1-58213-050-7). The report may be ordered by phone at (800) 232-5343 [mainland U.S.] or (415) 291-4415 [Canada, Hawaii, overseas]. A copy of the full text is also available on the Internet (www.ppic.org). The Public Policy Institute of California is a private, nonprofit organization dedicated to independent, objective, nonpartisan research on economic, social, and political issues affecting California.*

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