Research

Minimum Wage: Budgetary Savings vs. Labor Market Costs

BEN GITIS | DECEMBER 4, 2014

EXECUTIVE SUMMARY

American Action Forum (AAF) research finds that the labor market costs of raising the minimum wage far outweigh any budgetary benefits. Some argue that increasing the federal minimum wage would be an effective way to reduce dependence on federal government safety net programs such as the Earned Income Tax Credit (EITC) or Temporary Assistance for Needy Families (TANF). The evidence suggests, however, that the fiscal savings are minimal when compared to the labor market consequences. While other research finds that raising the minimum wage to $10.10 per hour would reduce safety net spending by $7.6 billion, AAF finds that it would also reduce job creation by 2.2 million jobs per year. For those who are unable to find work, this means a loss of $19.8 billion in earnings per year.

INTRODUCTION

Minimum wage has been the policy focus of the last year. While some policymakers in Washington advocated for an increase in the federal minimum wage, nine states and the District of Columbia began implementing minimum wage hikes of their own and an additional nine states plan to raise their minimum wages in the near future.

Supporters of a minimum wage hike claim one benefit of raising the minimum wage is that it would save the federal government money. Intuitively as low wage workers get a raise their dependence on public assistance will fall causing federal outlays in those safety net programs to decrease as well. However, such an analysis completely ignores the costs the policy imposes in the form of less job creation. When one considers the loss in income due to the minimum wage's labor market consequences, federal government savings are minor.

SAFETY NET SAVINGS ARE MINIMAL

Over the past year, researchers have noted that the federal government spends a considerable amount of public assistance dollars on low wage workers. For instance, the UC Berkeley Labor Center found that between Medicaid, food stamps, the EITC, and TANF, the federal government spends $243 billion per year on families with a working member. The implication is that raising the minimum wage would reduce government spending on working families.

While reducing spending on these safety net programs in exchange for wages is a laudable goal, it is important to keep two issues in mind. First, many U.S. safety net programs are designed to specifically help those who are employed in order to increase the value of working and incentivize those in poverty to enter the workforce. So if the U.S. government is spending $243 billion on working families, that indicates the programs are, at least in part, working the way we intend them to and providing those in need with substantial assistance while leading them to employment.

The EITC, for instance, only benefits families with labor earnings, meaning that in order to receive the credit a family must have at least one worker. The value of the credit received is a fixed percentage of family earnings; as earnings increase, so does the credit at a constant rate. The credit hits a maximum value and is then flat at the maximum value for a certain earnings range. When earnings rise above that range, the credit reduces a constant rate until the family phases out and no longer qualifies for the EITC. The result? The credit encourages low income employees to work more hours and earn higher wages. The EITC is successful because work is not only a key ingredient to survive in poverty, but also to climb out of it.

Second, just because the federal government spends money on low-income workers does not mean that raising the minimum wage will significantly reduce spending. In order for the government to significantly spend less on safety net programs, increasing the minimum wage would have to significantly improve the well-being of low-income families. But, it doesn't. Family income, not hourly wages, is what determines someone's economic well-being. Family income depends on a combination of factors including number of workers, hours at work, and wage rates. Since increasing the minimum wage would only directly impact one of those factors, it is a poorly targeted way to help those in need. So while the minimum wage may assist a few people in poverty, it can also benefit teens in high income families. AAF previously found that only about 20 percent of minimum wage earners are in poverty. 36.6 percent of minimum wage earners, meanwhile, live with their parents and have average family incomes over $100,000.

As a result, raising the minimum wage would not significantly reduce federal spending on safety net programs. The Economic Policy Institute found that raising the federal minimum wage to $10.10 would reduce public spending on working families by $7.6 billion per year.[1] Considering that the U.S. spends well over $200 billion each year on low-income working families, this is not a significant reduction in those programs' outlays. Clearly, that is because raising the minimum wage does little to help those in poverty and U.S. safety net programs would continue to provide assistance to working families.

LABOR MARKET CONSEQUENCES OF RAISING THE MINIMUM WAGE

When evaluating the impacts of raising the minimum wage, the labor market consequences cannot be ignored. While there is mixed evidence regarding the impact of the minimum wage on the level of employment, recent research by Meer and West (2013) suggests that a negative impact of the minimum wage can be isolated by focusing on employment dynamics. Specifically, they find that a 10 percent increase in the real minimum wage is associated with a 0.53 percentage point decrease in the net job growth rate.[2]

In a past study, AAF applied Meer and West's work to California's recent law that raises the state's minimum wage from $8 per hour to $10 per hour (effective 2016), finding that the wage increase will cost the state 191,000 new jobs. If every state followed suit, over 2.3 million jobs would be lost nationwide.

Loss in Job Growth

Using the same methodology and most recent data,[3] AAF finds that the proposal to raise the federal minimum wage to $10.10 per hour would cost about 2.2 million new jobs across the country. As illustrated in Table 1, the reduction in hiring ranges from 2,500 in Vermont and the District of Columbia to 235,100 in Texas. The net job growth rate would shrink in every single state and several states would have negative net job growth rates, indicating that the number of jobs would decrease. In addition, 30 states are currently experiencing positive employment growth and would face a decrease in employment if the minimum wage were $10.10 per hour.

Table 1: Reduced Hiring with $10.10 minimum wage (in thousands)			
State	**Loss in Annual Job Growth**	**Current Annual Net Job Growth**	**Annual Net Job Growth with $10.10 Minimum Wage**
Total	2157.6	2393.4	235.8
Alabama	39.8	33.5	-6.3
Alaska	5.4	-0.7	-6.1
Arizona	37.3	64.4	27.1
Arkansas	24.6	14.2	-10.4
California	98.8	319.5	220.7
Colorado	33.4	60.8	27.4
Connecticut	14.1	23.0	8.9
Delaware	6.9	12.3	5.4
District of Columbia	2.5	7.9	5.4
Florida	111.0	206.9	95.9
Georgia	84.5	95.4	10.9
Hawaii	12.9	6.6	-6.3
Idaho	13.3	9.0	-4.3
Illinois	69.1	39.4	-29.7
Indiana	61.5	49.6	-11.9
Iowa	32.1	15.4	-16.7
Kansas	28.8	13.8	-15.0
Kentucky	38.2	37.9	-0.3
Louisiana	40.9	24.5	-16.4

Table 1: Reduced Hiring with $10.10 minimum wage (in thousands)			
Maine	11.1	5.8	-5.3
Maryland	54.1	13.7	-40.4
Massachusetts	46.9	52.6	5.7
Michigan	52.3	26.3	-26.0
Minnesota	38.9	49.4	10.5
Mississippi	23.3	3.5	-19.8
Missouri	50.4	48.4	-2.0
Montana	6.6	6.8	0.2
Nebraska	20.5	8.3	-12.2
Nevada	14.1	28.6	14.5
New Hampshire	13.4	4.9	-8.5
New Jersey	46.9	9.2	-37.7
New Mexico	14.9	10.5	-4.4
New York	124.4	100.8	-23.6
North Carolina	85.4	84.7	-0.7
North Dakota	9.4	22.5	13.1
Ohio	75.5	37.6	-37.9
Oklahoma	34.1	36.6	2.5
Oregon	9.8	47.9	38.1
Pennsylvania	119.9	48.2	-71.7
Rhode Island	6.6	3.6	-3.0
South Carolina	39.8	37.2	-2.6
South Dakota	8.7	6.0	-2.7
Tennessee	57.6	59.8	2.2

Table 1: Reduced Hiring with $10.10 minimum wage (in thousands)			
Texas	235.1	421.9	186.8
Utah	27.1	48.8	21.7
Vermont	2.5	2.2	-0.3
Virginia	78.4	12.4	-66.0
Washington	13.3	74.7	61.4
West Virginia	15.9	12.7	-3.2
Wisconsin	59.2	28.2	-31.0
Wyoming	6.1	6.2	0.1

Loss in Earnings

How much would the loss in job creation hurt the 2.2 million people who would now be unable to find work? We answer this question by estimating the average weekly and annual labor earnings that each worker would not be able to earn. Research consistently indicates that when the minimum wage rises, low wage workers are mainly the ones who lose their jobs or are unable to find new jobs. So, this analysis conservatively assumes that the jobs lost are only those that pay hourly wages between $7.25 and $10.10 per hour. According to 2013 data from the Census Bureau's Survey of Income and Program Participation, workers who earn between $7.25 and $10.10 on average make $8.71 per hour and work 23.8 hours per week. As a result, someone who is unable to find a job due to the minimum wage increase would be unable to earn $207.30 per week on average. If the person would work year-round, that adds up to $10,780 lost per year.

So how much do those lost earnings add up to across the nation? Conservatively assuming that 70 percent of the 2.2 million job seekers would work year round and the remaining 30 percent would work half the year[4] yields that the reduction in hiring costs unemployed workers $19.8 billion total each year in lost earnings.

Table 2: Loss in Annual Earnings with $10.10 minimum wage	
State	**Loss in Earnings ($)**

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Total	19,769,253,787
Alabama	364,404,123
Alaska	49,653,170
Arizona	341,643,972
Arkansas	225,468,966
California	905,022,045
Colorado	306,052,993
Connecticut	129,627,176
Delaware	63,524,251
District of Columbia	22,953,804
Florida	1,016,632,385
Georgia	773,993,671
Hawaii	118,375,503
Idaho	122,250,721
Illinois	633,435,835
Indiana	563,930,128
Iowa	294,268,404
Kansas	263,953,890
Kentucky	350,354,072
Louisiana	374,998,931
Maine	101,698,412
Maryland	495,989,729

Table 2: Loss in Annual Earnings with $10.10 minimum wage	
Massachusetts	429,843,263
Michigan	479,157,598
Minnesota	356,622,038
Mississippi	213,843,312
Missouri	461,338,070
Montana	60,625,814
Nebraska	187,747,632
Nevada	129,085,052
New Hampshire	122,632,515
New Jersey	429,321,594
New Mexico	136,495,733
New York	1,139,964,220
North Carolina	782,526,786
North Dakota	85,751,130
Ohio	692,070,718
Oklahoma	312,518,199
Oregon	89,956,416
Pennsylvania	1,098,442,960
Rhode Island	60,282,586
South Carolina	365,072,264
South Dakota	79,546,963
Tennessee	527,965,050
Texas	2,154,563,957
Utah	248,300,300

Table 2: Loss in Annual Earnings with $10.10 minimum wage	
Vermont	23,311,974
Virginia	718,385,246
Washington	121,990,148
West Virginia	145,826,554
Wisconsin	542,110,550
Wyoming	55,722,963

The new minimum wage would force unemployed workers to forego total earnings ranging from $22,953,800 in the District of Columbia to $2.2 billion in Texas. Clearly, the cost of a $10.10 minimum wage is quite high for those 2.2 million people who are unable to find work.

CONCLUSION

The idea that the U.S. should raise the minimum wage in order to save the federal government money is misleading and completely ignores the policy's labor market costs. While the U.S. does spend a considerable amount of money on working families, raising the minimum wage would barely reduce outlays in safety net programs because it would do little to help those in need. Moreover, increasing the minimum wage would be detrimental to job creation as it would cost 2.2 million in new jobs and keep workers from earning about $19.8 billion each year. Clearly the labor market costs of raising the federal minimum wage far outweigh its minimal budgetary benefits.

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[1] This is a result of wage increases among those who are affected by the wage hike and are able to keep their jobs. CBO estimates that increased earnings resulting from a higher minimum wage would total $31 billion.