Insight

Budgetary Consequences of a $15 Minimum Wage for Contractors

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Executive Summary

- On April 27th, the Biden Administration issued an executive order raising the federal minimum wage for federal contractors to $15 beginning in 2022, arguing this shift will yield "value" to the taxpayer.
- This policy is similar to a 2014 Obama Administration policy, which was estimated to raise costs to the taxpayer by hundreds of millions per year.
- Based on more recent estimates, the Biden Administration policy will cost taxpayers as much as $1.2 billion per year, more than twice the cost of the Obama-era policy.

Introduction

On April 27th, the Biden Administration issued an executive order raising the minimum wage for federal contractors to $15 per hour. There is a robust policy debate about the merits of raising the minimum wage within the research community and among policymakers. Raising the minimum wage just for federal contractors simply asks the taxpayer to pay more than would otherwise be the case for federal services. This order marks the second time in the last 10 years that the federal government has pursued such a policy, with the Obama administration having increased the wage paid to federal contractors to $10.10 (indexed for inflation) per hour in a 2014 rulemaking. While both administrations have argued that higher pay (irrespective of any other productivity considerations) would yield "value" for the taxpayer, the effect is likely simply a new private-sector mandate with the cost passed on to the taxpayer.

The Executive Order

The Biden Administration's executive order raises the federal minimum wage for federal contractors to $15.00 from $10.95 for new contracts beginning in 2022. Beginning in 2023 and thereafter, the rate will be automatically indexed for inflation based on the Consumer Price Index for Urban Wage Earners and Clerical Workers – CPI-W (though not if the relevant index declines). This is the same index that is used to make cost of living adjustments to Social Security benefits. The order would also increase the minimum wage paid to tipped federal contractors to $10.50 in 2022 (presently $7.95), to 85 percent of the overall federal contractor minimum wage in 2023, and to 100 percent of the new federal minimum wage in 2024. The order further requires that for tipped workers, if total contractor pay inclusive of tips falls short of the overall contractor minimum wage, the employer must make up the difference. The order would also extend this wage to contractors with disabilities and rescind a prior ruling that exempted outfitters and guides operating on federal lands. Under the order, the Department of Labor is required to issue implementing regulations by November 24, 2021.

Regulatory History

In 2014, the Obama Administration increased the minimum wage paid to federal contractors to $10.10 from the federal minimum wage of $7.25 and indexed the wage rate for inflation. At the time, the Department of Labor (DoL) estimated that this policy would affect 183,814 federal contractors making less than $10.10. The administration estimated that these workers would, on average, see an increase in pay of $1.31 per hour. Assuming 2,080 annual working hours, and with an assumption that roughly 20 percent of all contracts in a given year are new, the DoL estimated that the change would raise costs to the taxpayer in the first year by about $100 million, and by about $500 million once fully implemented.

Cost to the Taxpayer

Just as was argued in 2014, the current administration predicts that the higher pay would lead to greater productivity and other benefits and thus "value to the taxpayer." What is striking is that this presumption is made in the absence of any other productivity enhancing policies. Rather, this policy simply redistributes taxpayer funds to a subset of contractors. The Congressional Budget Office (CBO) was asked in a 2014 hearing to estimate the cost of the Obama Administration's policy. The CBO director noted that contractors "may respond to that executive order by changing the mixture of employees and nonlabor inputs (for example, by substituting more machinery for workers). Or contractors may choose to reduce their profit margins in order to maintain the contract or to offset higher labor costs by, for example, hiring fewer but more efficient workers. Such changes in behavior would need to be accounted for in determining the effect of the President's action on future spending for contracts." The upshot of this assessment is that raising the cost of federal services is not "free" but rather introduces tradeoffs, not least of which is increased costs to taxpayers.

Under current law, workers on all federally funded or federally assisted construction projects must be paid no less than the "prevailing wage" in the area in which the construction project is located. First set forth by the Davis-Bacon Act of 1931, this policy raises the cost of federal projects by as much as 10 percent. Notwithstanding the serial claims that artificially raising federal labor costs delivers "value" to the taxpayer, the CBO has found that repealing Davis-Bacon would save taxpayers about $10 billion over the next decade.

The Biden Administration's policy would work in similar fashion to Davis-Bacon, raising costs to the taxpayer. Using methodology similar to that employed by the DoL in its 2014 estimate, the Economic Policy Institute (EPI) estimated that the new minimum wage policy would affect as many as 390,000 contractors and would provide an average annual pay increase of $3,100. Assuming this sum reflects a fully implemented cost, taxpayers will face new, annual costs of as much as $1.2 billion per year once the policy is reflected in all contracting prices. This total reflects both the growth in federal contractors since 2014 and the relative change in the applicable wage rate.

Conclusion

The new administration has fully embraced the notion that federal spending is largely free of tradeoffs or cost considerations: to wit, the recently announced increase in the minimum wage paid to federal contractors. The administration argues that having federal contractors pay more for labor costs than they otherwise would is somehow a bargain for the taxpayers. But published estimates suggest the entirely sensical observation that increasing costs to the government does in fact increase costs to the taxpayer.