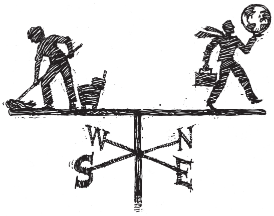

By Robert Pollin

ECONOMIC PROSPECTS

Making the Federal Minimum Wage a Living Wage

The Democrats moved rapidly after taking control of Congress to make good on their 2006 campaign promise to raise the federal minimum wage. The minimum wage is now scheduled to rise in three steps up to $7.25 an hour as of mid-2009. This is the first federal increase since 1997, when the $5.15 minimum was enacted. (As of this writing, the final version of the law still awaits reconciliation between the House and Senate bills that have passed. President Bush's approval will almost certainly follow a House/Senate agreement.)

Congress passed the $7.25 minimum wage because the political support for it outside the Beltway was rock-solid. Its foundation was the living wage movement that has organized and won victories throughout the country for over a decade.

In the November 2006 election, six states—Arizona, Colorado, Missouri, Montana, Nevada, and Ohio—passed minimum wage increases with a 65 percent average level of support. This means when the new federal minimum wage becomes law sometime in mid-2007, twenty-nine states and the District of Columbia, representing nearly 70 percent of the total U.S. population, will already be operating with minimum wage standards above $5.15. Beyond this, more than 140 municipalities now operate under some version of a living wage law, with the living wage minimum generally set between nine and eleven dollars per hour.

Voters throughout the United States clearly

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support the principle of living wage standards. But do we really know what a reasonable "living wage" minimum is for the country today? And if such a figure were to be enacted into law, would it lead to job losses for low-wage workers, as critics persistently assert? These are the questions that move us usefully beyond the official Washington frame of reference that is culminating with the new $7.25 minimum.

WHAT IS A LIVING WAGE?

Let's first be clear that $7.25 an hour as of mid-2009 is not close to a living wage. After controlling for inflation, $7.25 as of mid-2009 will likely represent an increase of only about 4 percent over $5.15 as of 1997, when $5.15 became the federal minimum.

Lawrence Glickman's 1997 book *A Living Wage: American Workers and the Making of Consumer Society* provides a good working definition of the term living wage: "It is a wage level that offers workers the ability to support families to maintain self respect and to have both the means and the leisure to participate in the civic life of the nation" (p. 66).

How can we translate Glickman's definition into dollars and cents, as we obviously must if living wages are to operate as a workable policy tool? When the modern living wage movement began in the mid-1990s, the approach that organizers took was to tie the living wage standard to the federal government's official poverty line. They set the living wage at least high enough to enable a full-time worker to maintain his or her family above the official poverty line.

But we confront an immediate problem with this approach, which is that the poverty line in the United States is seriously deficient. This is because it is calculated using an outdated approach which does not reflect the actual costs of providing for basic necessities other than food, including housing, health care, and child care. The poverty benchmarks also take no account of regional differences in the cost of living. As an average for the country, it is widely recognized among researchers that the official poverty benchmark for the country is probably about 40 to 50 percent too low. In high-cost urban areas such as Boston or Los Angeles, that figure should rise by roughly an additional 25 percent.

If we work with a revised poverty threshold at 140 percent of the official level, a national living wage standard in 2009 tied to such a poverty line would be about $11.50 an hour for a single mother with two children, working full-time, with no vacation and no health care. In high cost areas, the figure would rise to about $14.40 an hour.

But poverty thresholds need not be the only benchmark for defining a living wage. Glickman's definition certainly suggests a more generous approach. As one outgrowth of the living wage movement, researchers have recently developed estimates of what they term "basic budget" or "basic needs" standards for communities throughout the country. These figures provide what researchers at the Economic Policy Institute call a "realistic picture of how much income it takes for a safe and decent standard of living." Drawing from the Economic Policy Institute's basic budget estimates, a living wage standard in 2009 for the same single mother with two children, working full-time, would be about $17.50 an hour in Lincoln, Nebraska, and $31.60 in Boston.

It is clear that we cannot declare any single figure as best representing a living wage standard for all parts of the country and for all family sizes. But what is most notable from this exercise is that, starting at $11.50 and moving up to $31.60, these figures range between 60 and 400 percent above the 2009 official minimum of $7.25.

The unfairness of the $7.25 minimum in mid-2009 becomes clearer still when we consider the combined effects of price increases (inflation) and rise in labor productivity—i.e. the total basket of goods and services that the average worker produces in a year. The rate of inflation between 1997 and 2009 is likely to be about 3 percent per year. This means that the buying power of a $5.15 minimum wage will have fallen by about 40 percent over these years. Meanwhile, average labor productivity will have grown by well over 30 percent between 1997-2009. This allows businesses to pay their low-wage workers 30 percent more (in real, inflation-adjusted dollars) and have enough money left over for their profits to also rise by at least 30 percent. The fact that the minimum wage has been falling in inflation-adjusted dollars while productivity has been rising means that profit opportunities have soared while low-wage workers have gotten nothing from the country's productivity bounty.

UNINTENDED CONSEQUENCES?

It is certainly true that raising the minimum wage too high or too rapidly will discourage businesses from hiring low-wage workers. But at what point is the minimum wage increasing too much, too fast?

In the eleven states that operated with minimum wage levels above the federal minimum between 2001-05, employment growth was actually slightly faster than those states that operated with the $5.15 minimum. Careful studies of how living wage laws operate in San Francisco, Los Angeles, Boston, and Santa Fe, New Mexico, also show that businesses have kept employing low-wage workers basically as before.

Living wage opponents often claim that such empirical findings simply cannot be true. These opponents invoke the fundamental law of demand in economics to support their case. The law of demand does say that when you raise the price of anything (like low-wage labor), demand must fall (businesses hire fewer low-wage workers). But these critics regularly neglect a crucial feature of the law of demand, which is that it holds only when everything else in the economy remains unchanged. But, it is more plausible that other things are likely to change with a minimum-wage increase.

Most important, when demand for products is high, businesses will normally push hard to meet that demand. They will not lay off workers or stop hiring, regardless of whether or not the minimum wage is rising. For example, because demand was expanding strongly in 1997 when the minimum wage was last increased, the hike did not affect the unemployment rate. By the same token, recessions cause jobs to dry up, with demand for products falling, independent of whether the minimum wage had recently been raised.

A second factor is that businesses raise their prices to compensate for their higher labor costs. Of course, customers will reduce their spending if price increases are too large. However, in virtually all cases, the price increases needed to fully compensate businesses for the additional costs resulting from a living wage are modest.

For example, when Santa Fe raised its citywide minimum wage from $5.15 to $8.50

in January 2004, Mark Brenner and I estimated that restaurants—i.e. the businesses that employ the highest proportion of low-wage workers and are therefore most heavily affected by raises from a living wage law—would need to raise their prices by about 3 percent to fully cover their additional costs. Thus, a $10 fried haddock dinner in Santa Fe would now have to sell at $10.30. Increases at this level are not going to stop people from dining out.

So too, workers give more effort when they are paid decently. A higher minimum wage should therefore mean lower absenteeism and turnover, helping firms to compete on the basis of higher productivity and better product quality as opposed to the lowest possible, race-to-the-bottom, labor costs. The evidence from Boston, Los Angeles, and San Francisco does show real, if modest, productivity improvements tied to the living wage increases.

DOES EXPANDING THE EITC MAKE MORE SENSE?

The Earned Income Tax Credit (EITC) is an income subsidy for poor people who have jobs, providing them and their families an average of about $2,000 to offset their low wages. The EITC is now by far the country's largest antipoverty program, with a total of about forty billion dollars per year being sent to about twenty million families. Living wage opponents frequently argue that expanding the EITC is much more effective than the living wage as a means of helping the working poor. It certainly will not discourage businesses from hiring low-wage workers. It may even encourage hiring, since it enables businesses to pay destitution-level wages without requiring workers to actually live in destitution. Living wage critics also claim that the EITC is better targeted, with all of its money being channeled to the poor, while a living wage increase could benefit middle-class housewives and teenagers.

The living wage and EITC should be seen as complimentary to one another, not as competitors. Eighty to ninety percent of the workers who get living wage increases are adults well into their long-term career paths. The overwhelming majority also come from families living below a basic budget line.

The primary strength of establishing a decent minimum wage standard is that it rewards work directly, in people's paychecks. This creates more motivation and self-respect among workers, which in turn produces a virtuous cycle of higher productivity and lower absenteeism. In addition, raising the minimum wage also does not impose increased burdens on government budgets. Indeed, a higher minimum wage will mean lower government subsidies, including Medicaid, food stamps, and the EITC itself. More workers' self-sufficiency and less government dependency: aren't these bedrock conservative principles?

How can these two policies serve each other? We should clearly want to capture the gains in morale and productivity that result from higher wages. At the same time, nobody would want to raise the minimum wage mandate to a level that would discourage employment. The most effective strategy would be to push the minimum wage just to the point before it does begin to discourage hiring. Beyond that, the EITC can still serve as a needed income supplement.

GETTING FROM HERE TO THERE

The Santa Fe ordinance provides a model of how we might proceed cautiously toward a national living wage standard. This 2004 measure established raises from the federal $5.15 standard to $10.50 as of January 2008, to be implemented in three steps. But before progressing with each scheduled raise, the city first determines whether the previous raise caused negative employment effects. The Santa Fe minimum rose to $9.50 last January, after the city established that employment growth under a $8.50 minimum had been healthy.

A federal government variant could entail implementing the newly established $7.25 minimum as of mid-2009, but also allow for increases every two years thereafter, once it is established that no negative employment effects resulted from the previous raise. The 2011 increase could be to $9.00, i.e. to roughly the low-end living wage standard in communities throughout the country today.

Increases beyond this could then be tied both to inflation and average labor productivity. This would mean a roughly 10 to 12 percent increase in the federal minimum every two years, if inflation and productivity trends were to continue as they have for the past decade. The raise in 2013 would then be to about ten dollars.

Even a $10.00 federal minimum in 2013 will not be adequate for most of the country. Local communities and states will need to continue setting their own living wage norms. But the idea of providing raises in line with average productivity and inflation, after taking account of employment effects, should at least move the country closer to what voters have demonstrated they support, what the economy can readily absorb, and what low-wage workers deserve. ■

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* This column draws in part from my forthcoming co-authored book, *A Measure of Fairness: The Economics of Living Wages and Minimum Wages in the United States* (Cornell University Press, 2007).