

MINIMUM WAGES AND THE CALIFORNIA ECONOMY

The Economic Impact of AB 48

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and GINA VICKERY***UC Berkeley Institute of Industrial Relations***1****INTRODUCTION AND MAIN FINDINGS**

California policymakers are considering raising the statewide minimum wage, which has remained at \$6.75 since January 1, 2002. Assembly Bill 48 would increase California's minimum wage from \$6.75 per hour to \$7.25 per hour, effective January 1, 2006, and to \$7.75 per hour, effective January 1, 2007. AB 48 would also require the state to adjust its minimum wage annually for inflation, effective January 1, 2008.

The real minimum wage (corrected for inflation) has decreased by more than 30 percent since 1968. In 2004, California's minimum wage was 32 percent of its average wage. This ratio has also declined by nearly 30 percent over the last 35 years and is hovering at historic lows.

The Institute of Industrial Relations at UC Berkeley conducts a policy-oriented research program on California labor markets, including

the collection of new survey data from the state's businesses -- the UCB California Establishment Survey. The survey provides a more detailed picture of company policies on work and pay than was previously available. Using this survey and other data sets, IIR recently completed a series of studies on the potential economic impacts of AB 48 on California's workers, employers and taxpayers.¹

MAIN FINDINGS**■ Impacts on Workers**

-- AB 48 would directly increase the wages of nearly 1.65 million workers in California's private sector.² An additional 700 thousand workers would benefit through indirect wage effects. Nearly 60 percent of these low-wage workers are Latino. Low-wage workers are also

¹ This policy brief is based upon research conducted at IIR by Michael Reich, Arindrajit Dube and Amy Vassalotti. To view these studies, as well as other research on minimum wage impacts, please visit IIR's website (www.iir.berkeley.edu/research/minimumwage.html).

² All findings are for a statewide minimum wage of \$7.75 per hour.

disproportionately female. Although teenagers comprise a large portion of the low-wage workforce, the average low-wage worker is 33 years old.

-- *AB 48 would not have a measurable adverse effect on job creation.* Detailed studies of California's last two decades of state minimum wage legislation consistently find no loss of employment for workers, in part because the minimum wage remains low by historic standards. In the restaurant industry, most affected by minimum wage increases, employment has increased by 8.9 percent since the 2001-2 minimum wage increases. During the same period, California's total private employment increased by 0.4 percent.

-- *AB 48 raises the pay floor required to exempt salaried workers from overtime eligibility, but the associated costs for employers are negligible.* Most exempt workers are already paid well above the new floor, so the number potentially affected is small, less than 0.5 percent of private sector employment. When the minimum wage was last increased, in 2001-2002, very few of these workers received pay increases as a result.

■ Impacts on Employers

-- *AB 48 would increase operating costs of the average business by approximately 0.7 percent.* About three-fourths of businesses would experience increases in operating costs of no more than one percent. Increases of such magnitudes are likely to be met primarily through very small price increases. Increased productivity and reduced turnover costs would also help absorb cost increases.

-- *AB 48 would have a larger impact on operating costs in the food services industry (restaurants)—about 2.7 percent.* Although other industries are more labor-intensive, food services account for one-fourth of all low-paid workers. Restaurants face localized demand and businesses could easily shift cost increases of this magnitude to consumers through price increases of a similar amount.

■ Impacts on Taxpayers

-- *AB 48 would reduce the need for expenditures on public assistance programs, such as Medi-Cal and food stamps, and save taxpayers over \$2 billion in reduced program costs.* Many of the participants in these programs are members of households with at least one employed individual and the usage of these programs falls as wage rates increase.

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AB 48 - LEGISLATIVE HISTORY & ANALYSIS

AB 48 was authored by Assemblymember Sally Lieber in late 2004. It would increase California's minimum wage from \$6.75 per hour to \$7.25 per hour, effective January 1, 2006, and to \$7.75 per hour, effective January 1, 2007. The bill is expected to be approved by the Legislature and to reach the Governor's desk in September 2005.

AB 48 is similar to AB 2832, which passed both houses of the Legislature in 2004, but was vetoed by Governor Schwarzenegger in September, 2004. Unlike AB 2832, AB 48 requires the value of the minimum wage to be adjusted each year, starting in 2008, to keep the minimum wage in line with inflation. This indexing reduces the need to reconsider minimum wage increases year after year.

In March 2005, the Legislative Analysts Office (LAO) reported on the potential fiscal effects of an increase in California's minimum wage.³ The LAO warned policymakers that businesses may respond to an increased minimum wage by raising prices, substituting machines for labor, or relocating outside of California. The LAO also found that AB 48 would lead to some decline in employment and a loss of business activity within the state.

The LAO's predictions, however, are quite general and are not based upon a specific study of the impacts of AB 48 or upon recent experience. IIR's study uses a new dataset, the California Establishment Survey (CES), together

³ <http://www.lao.ca.gov/ballot/2005/050143.htm>

with the U.S. Census Bureau's Current Population Survey, to conduct more locally relevant analysis. The CES contains detailed information on California's businesses, including industry, firm size, operating costs, labor turnover, and the nature of the workforce.

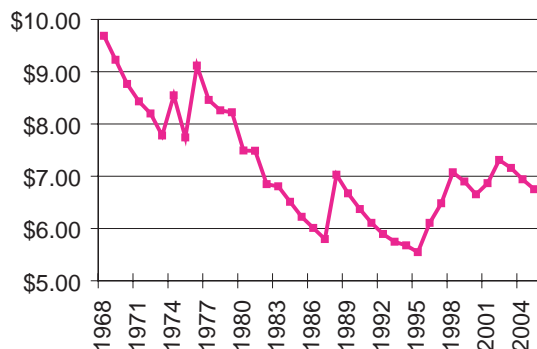
3 RECENT MINIMUM WAGE POLICIES

The real value of the California minimum wage peaked in 1968 at \$9.68 (in 2005 dollars). Since the California minimum wage is not indexed to inflation, the real value diminishes over time. Adjusting for inflation, the current minimum wage of \$6.75 is more than 30 percent lower than it was in 1968 (see Figure 1).

The low value of the federal minimum wage (\$5.15) has prompted seventeen states to enact statewide minimum wage requirements that exceed federal mandates. Washington and Oregon have statewide minimum wages of \$7.35 and \$7.25 respectively. Washington and Oregon also index their minimum wages to inflation.

In 2004, California's minimum wage was 32 percent of its average wage (Levy 2004). Despite recent minimum wage increases, this ratio is hovering at historic lows. Over the last 35 years, California's minimum wage as a percentage of its average wage has declined by nearly 30 percent. This decline has significant implications for California's low-wage workers, who face a relatively high cost of living and income inequality.

FIGURE 1 - CALIFORNIA'S MINIMUM WAGE IN JUNE 2005 DOLLARS



Source: CPI-U urban workers in California, compiled by Division of Labor Statistics (Department of Industrial Relations, CA).

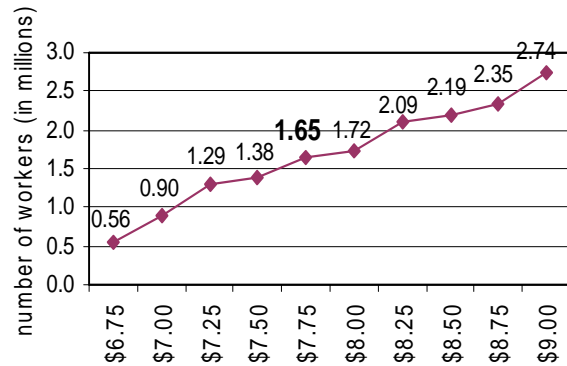
4 POTENTIAL ECONOMIC IMPACT OF AB 48

AB 48 would increase California's minimum wage by 14.8 percent, compared to previous increases of 17.4 percent in 2001-2 and 35.3 percent in 1996-8.

IMPACTS ON CALIFORNIA WORKERS

In 2004, approximately 13 percent of California's private sector workforce, or 1.65 million workers, earned less than the proposed minimum wage of \$7.75. AB 48 would directly benefit these low-wage workers. Figure 2 indicates the number of workers that would be affected at alternative minimum wage levels.

FIGURE 2 - NUMBER OF WORKERS DIRECTLY AFFECTED AT ALTERNATIVE MINIMUM WAGE LEVELS



Source: Computed by the authors from the 2004 Current Population Survey, US Census Bureau.

An *additional* 700 thousand workers would benefit through indirect wage effects. Indirect benefits accrue when employers increase the wages of workers earning slightly above the newly mandated minimum wage. This "ripple effect" preserves some of the existing wage hierarchy near the minimum wage. Indirect wage effects are calculated based on previous IIR work in this area. Workers earning \$7.75 before the wage increase would receive a wage increase of approximately 50 cents; the ripple effect declines at higher wages and phases out entirely for workers already earning \$8.75.

On an annual basis, full-time workers would receive an average increase of about \$1,000 per year and the total increase in worker purchasing power would amount to about \$2.45 billion.

Nearly 60 percent of low-wage workers are Latino, while Latinos make up 34 percent of the overall California workforce. Low-wage workers are also disproportionately female. About 64 percent of low-wage workers report working at least 40 hours per week. Although teenagers comprise a large portion of the low-wage workforce, the average low-wage worker is 33 years old. The minimum wage rate is relevant to the well-being of many Californian families, not just to teens.

Impacts on Employment

The employment effects of previous California minimum wage increases have been studied by Card (1988 increase), Reich and Hall (1996-8 increases) and Woods (2001 increase). None of these studies found that increases in the California minimum wage led to a measurable employment loss. Our analysis of the 2001-2 minimum wage increases estimates that 1.5 million Californians received direct wage increases, without negative employment effects.

Prior to the 2001-2 minimum wage increases, 13 percent of the workforce earned less than \$6.75. Similarly, 13 percent of today's workforce earns less than the proposed minimum wage of \$7.75, suggesting that the increase would have similar effects.

In the restaurant industry, most affected by minimum wage increases, employment has increased by 8.9 percent since the 2001-2

minimum wage legislation (see Figure 3). During the same period, California's total private wage and salary employment has increased by 0.4 percent.

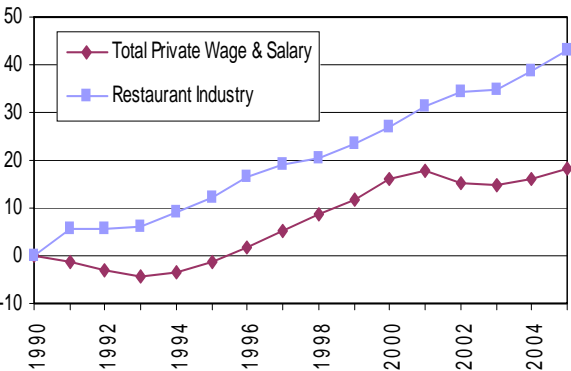
In 2004 San Francisco implemented an \$8.50 citywide minimum wage (26 percent higher than the state minimum). A recent study (Dube, Naidu and Reich 2005) on the effects of this policy on San Francisco restaurants found that it did not decrease employment in the restaurant industry.

Impacts on Employers of Exempt Workers

An increase in the minimum wage may affect workers who are exempt from state overtime requirements. Exempt workers are salaried workers whose jobs must also contain specified managerial or supervisory components, as outlined by the Fair Labor Standards Act. To qualify employees for exempt status in California, their pay must be at least twice the full-time annual pay rate implied by the minimum wage. Currently, California employers must pay exempt workers at least \$28,000 per year. Twice the proposed minimum wage of \$7.75 is equivalent to an annual salary of just over \$32,000. AB 48, therefore, could lead to pay increases for exempt workers who earn between \$28,000 and \$32,000. But most exempt workers already earn well over \$32,000 and would not be affected by AB 48.

Based on our calculations using the Current Population Survey (CPS), 907,000 private sector full-time workers in California earn between \$28,000 and \$32,000. The best estimate is that seven percent of these workers -- 64,000 -- are both salaried and have managerial or supervisory duties that qualify them for exempt status.⁴ If AB 48 affected all 64,000 workers, 0.5 percent of all California's private sector employees would receive pay increases of about \$1 per hour, on average. Increased operating costs as a result of increased salaries for exempt workers, therefore, would be small in magnitude. However, employers could choose to reclassify these workers as non-exempt instead of providing pay increases.

FIGURE 3 - PERCENT CHANGE IN EMPLOYMENT: TOTAL EMPLOYMENT VS. THE RESTAURANT INDUSTRY

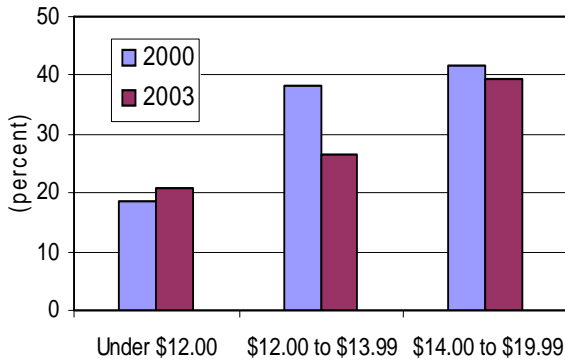


Source: Labor Market Information Division, Employment Development Department, State of California.
 * Percent change in employment relative to 1990 base year; restaurant industry refers to food service & drinking places.

⁴Trejo (2003) uses CPS data, along with job data on managerial and supervisory duties, and finds that 14 percent of the overall full-time work force is exempt. Well over half of these workers are paid more than \$15.50 per hour.

Evidence using the CPS shows that after the most recent minimum wage increases (2001-2), California employers did not increase wages of these employees in order to keep them exempt. After the minimum wage change, the proportion of workers in this range who were classified as *hourly* was higher than before (Figure 4).

FIGURE 4 - SALARIED PROPORTION OF THE WORKFORCE, BY WAGE LEVELS



Source: Authors' calculations using the Current Population Survey, US Census Bureau.

IMPACTS ON CALIFORNIA EMPLOYERS

Impacts on Costs

AB 48's impact on business' operating costs tells us how much firms might increase their prices and/or reduce their profits.⁵ Overall, the estimated increases in operating costs are modest. The average establishment would face an increase in operating costs of 0.6 percent due to direct effects and 0.7 percent including both direct and indirect effects. Table 1 shows that 98.5 percent of businesses would face overall cost increases of less than 5 percent.

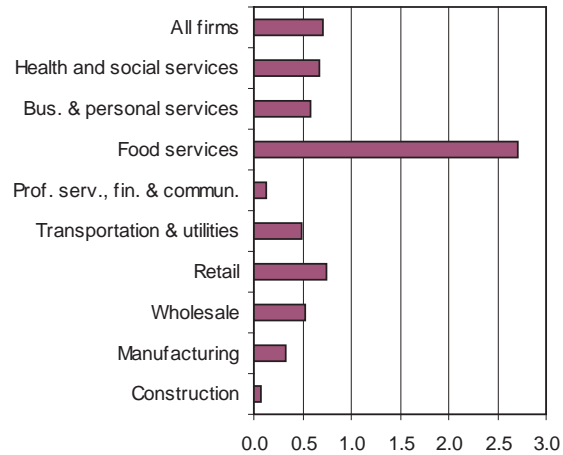
TABLE 1 - PERCENT OF ESTABLISHMENTS WITH AN INCREASE IN OPERATING COSTS OF NO MORE THAN...

| | 0 Percent | 1 Percent | 3 Percent | 5 percent |
|-------------------|-----------|-----------|-----------|-----------|
| Direct | 34.3 | 81.4 | 96.2 | 98.6 |
| Direct & Indirect | 34.3 | 77.6 | 93.8 | 98.5 |

Source: Computed from UCB California Establishment Survey, US Census Bureau.

Figure 5 summarizes increases in operating costs, by industry. Establishments in the food services industry face, by far, the largest increases in operating costs.

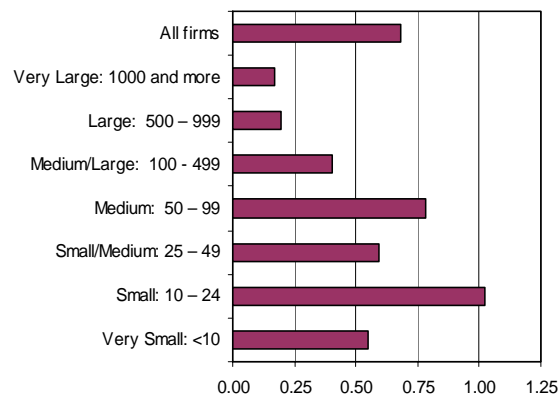
FIGURE 5 - PERCENT INCREASE IN OPERATING COSTS, BY INDUSTRY



Source: Computed from UCB 2003 California Establishment Survey.

AB 48 would increase operating costs at small business more than at large businesses (Figure 6).

FIGURE 6 - PERCENT INCREASE IN OPERATING COSTS, BY BUSINESS SIZE



Source: Computed from UCB California Establishment Survey, US Census Bureau.

⁵ In calculating changes in operating costs, the study assumes businesses would not alter employment levels in response to AB 48. As discussed below, the accommodation and food services industry would be most affected by AB 48, and decreased employment levels are not likely in this industry, based on extant evidence.

Impacts on the Restaurant Industry

The food services industry warrants further examination. While California restaurants employ only six percent of the total workforce, they employ one out of every four low-wage workers in the state. Restaurant owners would see a 2.7 percent increase in their operating costs.

Impacts on Prices

Previous minimum wage studies have found that prices increase somewhat less than increases in business operating costs. In the case of AB 48, prices would therefore increase by less than 0.7 percent. Even if operating cost increases were fully passed onto consumers, prices in restaurants—the industry that is most affected—would increase by about 2.7 percent. Research suggests that such small price increases in the restaurant industry would not affect consumer demand (Kelly *et al* 1994).

Other Business Impacts

While we expect businesses to respond to increased operating costs through increased prices, businesses may utilize other methods of adjustment. Research on efficiency wages, or wages higher than the competitive wage, suggests that increased pay reduces turnover and absenteeism and improves worker productivity. Minimum wage increases may have similar effects.

Relocation to a state with a lower minimum wage is unlikely since cost increases in mobile industries would be small. Establishments in the accommodations and food services industry rely on a localized customer base, and relocation is not an option. The closing of establishments is also unlikely since cost increases are generally not high enough to warrant such a response.

IMPACTS ON CALIFORNIA TAXPAYERS

Many recipients of public assistance in California are employed or living in a family with at least one employed person. The largest public assistance programs are Medi-Cal, the Earned Income Tax Credit and child care assistance. A recent study at IIR (Zabin *et al* 2004) combined

administrative data from ten such programs with Current Population Survey supplements and found that take-up rates for these programs fall as wages increase. The study suggests that increasing the minimum wage to \$7.75 would therefore reduce public spending by about \$2.15 billion.

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CONCLUSION

AB 48 would increase California's minimum wage by 14.8 percent, compared to previous increases of 17.4 percent in 2001-2 and 35.3 percent in 1996-8. Previous experience and new data both indicate that the state economy has the capacity to absorb such minimum wage increases. In recent decades, the restaurant industry has faced relatively large increases in operating costs as a result of minimum wage legislation. Despite these increases, the restaurant industry has continued to grow faster than the state economy.

The most likely business response to AB 48 would be a slight increase in prices, largely unnoticed by consumers. Taxpayers would find that the need for public assistance would decline somewhat. AB 48 would raise the income of California's lowest-wage workers without burdening the state's economy.

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IIR brings together faculty and graduate students from across the campus and supports multidisciplinary research on all aspects of labor and employment relations. Activities throughout IIR are coordinated through centers and units that have a specific charge or focus. These units are organized under two broad program areas: Academic Initiatives, lead by UCB faculty members; and Community Outreach & Research, managed by professional staff members with strong faculty involvement.

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