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A Minimum Wage That Makes More Sense

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Travel around this country a bit and, assuming your purchases are not confined to airports and big hotel chains, you will find that prices vary a great deal. Prices in New York State are 15 percent above the national average, while those in Arkansas are 12 percent below average. Housing is about twice as costly in Massachusetts as in Mississippi.

These estimates arrive courtesy of the Bureau of Economic Analysis' regional price parities, or R.P.P.s. The much better known Consumer Price Index, or C.P.I., tells us how national prices change over time. The R.P.P.s tell us how prices differ at a particular time across the country.

I've been thinking about these R.P.P.s since I read a new paper by the economist Arindrajit Dube, an associate professor of economics at the University of Massachusetts, Amherst, on ways to incorporate price differences across states when setting state or local minimum wages. It's a worthy idea: Just a quick look at an R.P.P. chart suggests that the buying power of a uniform federal minimum wage varies greatly across the land.

Since price differences correlate with wage differences, a proposal to increase the federal minimum will affect a greater share of workers in states with lower prices.

For example, consider the proposal to increase the minimum wage to $10.10. When we adjust a national minimum wage of $10.10 for regional differences, these are the amounts you'd need to have the same buying power: $11.94 in Washington, D.C., and $11.40 in California, but only $8.90 in Alabama and $9.08 in Kansas.

And of course, prices vary within states as well. In the New York City area, it would take $12.34 to meet the national buying power of $10.10; upstate around Buffalo, you'd need only $9.47. In the Los Angeles area, it would take $11.94; go up north a bit to Bakersfield, where prices are closer to the national average, and it's $9.83.

Ikea had this very notion in mind when it announced that it would raise the minimum wage of its employees. The hourly wage for each store will be based on the cost of living in that particular area, ranging from $8.69 to $13.22.

Because most workers' wages are lower in states where prices are relatively low, a $10.10 minimum wage will tend to reach a lot more workers in Alabama than in Connecticut. According to an analysis by David Cooper at the Economic Policy Institute, the proposed federal increase would lift the pay of 24 percent of Alabama's work force, but only 14 percent of Connecticut's.

Some states and cities have already taken this matter into their own hands, setting their own minimum wages above the federal level to account for price and wage differences. (They have also done this because the federal minimum wage has become a political football that is often fumbled.)

At the current $7.25, the minimum wage is too low pretty much anywhere to provide working families much of an income (and, as I explain here, adults increasingly depend on the minimum wage to make ends meet). This year, 22 states have their own minimums, ranging from $7.40 in Michigan to $9.32 in the state of Washington. Seattle just agreed to take its minimum up to $15 on hour, though with a phase-in period of quite a few years.

Mr. Dube suggests two ways to set the minimum wage to account for this price and wage variation. One, set the minimum at half the state median wage. Why half?

Why median? While any such choice would have an element of arbitrariness to it, in the 1960s and 1970s, when policy makers regularly attended to the national minimum wage, its average relative to the median was 48 percent. That's one reason economic inequality didn't grow much in those years. Internationally, the average minimum-to-median among countries tracked by the O.E.C.D. is also about 50 percent. "In contrast," Mr. Dube writes, "the U.S. minimum wage now stands at 38 percent of the median wage, the third-lowest among O.E.C.D. countries after Estonia and the Czech Republic."

How does this idea relate to R.P.P.s? As I noted, the correlation between state-level wages and prices is high, so benchmarking a state's minimum wage to its median is one way to account for regional price differences.

But a more direct way is to simply take half the national median, $9.75 in 2014, according to Mr. Dube, and adjust it for R.P.P.s.

Since median wages vary a lot more than prices across states, I tend to think that this recommends the R.P.P. To me, it's (slightly) more attractive to adjust minimum wages for price differences/buying power than for relative wages.

But there's a larger point here. Economists endlessly and fruitlessly argue about whether the impact of minimum wages on jobs is very small or zero. Policy makers who most resist minimum wage increases tend to be ones representing the interests of states with lower prices and wages. To their credit, many states and even some cities are ignoring this unhelpful debate and taking action to raise the pay of their low-wage work force, push back a bit on inequality, and work around Washington's dysfunction. If adjustments for local wages and prices makes this go down easier, so much the better.

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