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ECONOMY

Raising Floor for Minimum Wage Pushes Economy Into the Unknown

By NOAM SCHEIBER JULY 26, 2015

WASHINGTON — The fight for a $15 minimum wage has gained momentum in New York, California and other places around the country in recent months. But as a national strategy to raise incomes at the bottom of the pay scale, it faces major obstacles, both political and economic.

In many states, particularly those governed by Republicans in the South and the Midwest, there is little chance of raising the minimum wage above the federal level, which has stood at $7.25 since 2009. Congressional Democrats have introduced a proposal to raise the minimum wage to $12 by 2020, but Republicans typically argue that raising the wage floor costs jobs and hurts the very people it is intended to help.

Even where the proposals are politically viable, the economic challenge could prove daunting. That is because the sheer magnitude of the recent minimum wage increases sets up an economics experiment the country has rarely if ever seen before.

"There could be quite large shares of workers affected, and research doesn't have a lot to say about that," said Jared Bernstein, a former White House economist now at the Center on Budget and Policy Priorities who generally favors higher minimum wages. "We can't assume that because the proposal is out of sample it's going to blow up. But we have to be less certain about the outcome."

A number of researchers have found that modestly higher minimum wages can raise incomes for low-wage workers without reducing the number of jobs in an area.

Their evidence rests largely on comparisons between neighboring areas with different minimum wages. The seminal study in this vein examined fast-food restaurants on both sides of the Pennsylvania-New Jersey border before and after New Jersey raised its minimum wage in the early 1990s. It found no evidence that employment there fell as a result.

While economists using other methods continue to find a range of job losses, some of their recent estimates of losses in the restaurant business tend to be small.

But the $15-an-hour proposals go far beyond the experience of the last few decades, and the recommendations of a panel appointed by Gov. Andrew M. Cuomo to raise the minimum wage for workers at fast-food chains to such a level thrust New York State to the forefront of the current experiment.

To appreciate the nature of the recommendations, which the state's acting labor commissioner is expected to formally accept within the next few months, it is helpful to compare the new fast-food minimum wage to the wage of a typical worker in a given metropolitan area, an exercise that is common among economists. The closer the minimum wage is to the median wage — the amount earned by workers in the middle of the pay scale — the greater the likely impact, for better or worse, though the effect of singling out one industry is unclear.

Based on projections from government data, the proposed $15 minimum wage for fast-food workers could represent more than 60 percent of the wage of a typical New York City worker when it takes effect at the end of 2018, though rising wages for middle-income workers could diminish that figure somewhat.

Such a ratio lies at the outer limit of the country's historical experience with the minimum wage, at least before the recent increases in cities like Seattle and Los Angeles, most of which have yet to be fully phased in.

In 2003, a citywide minimum wage increase in Santa Fe, N.M., was roughly as steep, though it exempted small businesses. In the late 1970s and early 1980s, the local minimum wage stood at over 60 percent of the local median wage in several Southern and low-population states thanks to increases in the federal minimum wage, according to data compiled by Ben Zipperer of the Washington Center for Equitable Growth.

Several economic analyses of the Santa Fe increase suggested it had little effect on employment, while the effects of the earlier increases have not been extensively studied with modern tools.

Still, as ambitious as the proposed increase is for fast-food workers in New York City, it pales in comparison to the increase in the rest of the state, where the new $15-per-hour minimum for fast-food workers would take effect in July 2021. The minimum wage for fast-food workers could rise to 75 percent or more of the wage for a typical worker in a number of cities across the state, like Binghamton, Buffalo and Utica. There is little precedent for an increase of this magnitude.

There are other reasons to believe that employers in expensive cities like New York, San Francisco and Los Angeles are better able to adapt than employers in other cities and less populated areas, economists say.

Most important, because rent is far more expensive in these cities, wages are a smaller fraction of a business's overall costs. A given increase in the minimum wage typically has a smaller effect on the bottom line of a business there than in an area with cheaper rent.

Likewise, businesses in high-cost cities often have transient customers who are less price-sensitive, making it easier for them to partly offset higher wages through price increases.

"Some of these cities are tourist destinations," said David Cooper of the Economic Policy Institute. "Folks go and spend the money anyway." Businesses in less-frequently visited places do not have the same luxury.

Wanda Austin-Peters, who owned a Subway franchise in Albany for 10 years until she sold it in May, said labor normally accounted for 50 percent or more of her costs in a given year — relatively high compared with an industry average of around one-third. She added that she had little ability to raise prices.

"It would be stupid to charge $7 for a footlong sandwich that everyone else has for $5," Ms. Austin-Peters said. "There's a Subway cropping up in every corner."

Even when they don't lead to job losses over all, minimum wage increases can be disruptive, driving a number of operations out of business even as they give rise to a largely offsetting increase in new businesses and jobs.

The businesses best suited to the higher-wage world often lean more heavily on machines than their competitors or derive greater economic benefits from paying their workers a higher wage.

Cole Hardware, a chain of five Bay Area stores, four of which are in San Francisco, is an example of the latter. Rick Karp, the owner, said his business was largely unaffected when the local minimum wage rose to $12.25 per hour in May because his lowest-paid employees already made $13 per hour, while veteran workers made $17 and higher.

According to Mr. Karp, paying higher wages has reduced turnover and allowed him to provide higher-quality service with employees who are more experienced. "If you come into our business, we want our staff to recognize you, treat you as a friend," he said. "We can't do that with minimum-wage employees."

Mr. Karp, who estimated that his prices were about 10 percent higher than those at Amazon, his most intense competitor, said he believed that his customers were willing to pay a small premium in return for knowledgeable and personal service.

“We’ll spend 20 minutes with you helping to find a faucet washer or an expensive grill,” he said. “It’s a different experience.”

A number of studies co-written by the Berkeley economist Michael Reich show that mandated wage increases for low-income workers do significantly reduce turnover. Other studies show that the cost savings can be substantial.

Still, the uncertainty of the new $15-per-hour world is why even economists relatively sympathetic to minimum wage increases, like Arindrajit Dube, Mr. Reich’s frequent collaborator, argue that it makes the most sense to treat cities like New York and San Francisco differently from other parts of their states, to say nothing of less populous states where wages are much lower.

Others, like David Neumark, an economist at the University of California, Irvine who has long emphasized the costs of minimum wage increases, argue that it would be far more efficient to help lift people out of poverty using wage subsidies like the earned-income tax credit than to rely on the minimum wage, which frequently helps workers in families whose incomes are already above the poverty level.

Recent research suggests that the earned-income tax credit is highly effective at reducing poverty, although far fewer people claim it than are eligible, often because the working poor have little experience claiming tax benefits.

Activists say they have nothing against measures like the tax credit, though they say that Congress is not exactly tripping over itself to expand the credit, whereas organized political action can raise the minimum wage today.

In any case, they add, the narrow economic logic of the minimum wage misses the broader rationale for their efforts.

“Raising the minimum wage for everyone says something profound and profoundly good about the society we want to live in,” said Dan Cantor, national director of the Working Families Party, which has helped secure minimum wage increases in several cities and states across the country. “That all work has dignity and worth, and people deserve a living wage.”

Patricia Cohen contributed reporting from New York.

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