

Monitoring THE Minimum Wage

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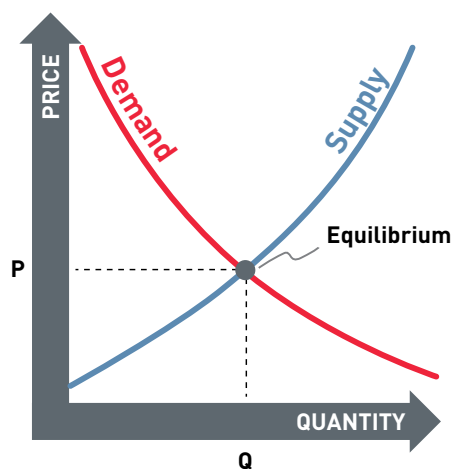
The *Monitoring the Minimum Wage* brief series is produced by The Workforce Field Building Hub (The Hub), a signature initiative of New York City-based Workforce Professionals Training Institute. This project provides resources gleaned from economic research and insights from local businesses and community-based organizations designed to help workforce practitioners and their public and philanthropic funders respond to the opportunities and challenges posed by the increasing minimum wage. This brief was prepared by Hub Senior Fellow Dr. James Parrott, a long-time NYC labor market analyst and policy expert who also serves as Director of Economic and Fiscal Policy at the Center for New York City Affairs at The New School.

BRIEF 2:

How will a higher minimum wage affect businesses and the economy?

by James Parrott

We can't really talk about this topic without relying on some basic economics. A business without profits, or the prospect of profits, won't be around for long. Profits represent the difference between total sales (or revenues) of the business, and the total costs of producing the goods or services that it sells. Wages paid to workers are part of total costs. But when wages rise, costs don't necessarily rise in tandem. It's not that simple, although popular accounts of the effects of higher minimum wages often end up making it appear that simplistic.



The basic Economics 101 supply-and-demand notion that if you increase the price of something, you decrease the demand for it, doesn't apply to the labor market in the same way. Increasing (or decreasing) the price (wage) of a worker, changes the nature of that input—it can change

the behavior of workers in ways that absorb some of the higher payroll costs.

Estimating the Impacts of a Minimum Wage Increase in New York – The Research

To inform the debate in early 2016 on Governor Cuomo’s proposed \$15 minimum wage legislation, two New York-focused reports were published by reputable economic research organizations.

[The Effects of a \\$15 Minimum Wage in New York State](#): A team of researchers at the University of California, Berkeley’s Institute for Research on Labor and Employment (IRLE), led by Michael Reich, a national expert on labor economics, prepared a detailed analysis of the prospective impacts of a phased-in \$15 minimum wage in New York State. The IRLE study was the first of its kind in focusing on New York to carefully analyze arguments made both for and against minimum wage increases, taking into account how workers, businesses and consumers are affected and likely to respond to such a policy change, and then integrating those responses in a comprehensive and unified manner. The report’s analytic framework is reflected in the flow chart diagram (page 3) and discussed throughout the brief.

[Raising the New York State Minimum Wage to \\$15 by July 2021 Would Lift Wages for 3.2 Million Workers](#): The other New York-specific report prepared in early 2016 was by the Washington, D.C.-based Economic Policy Institute. This report included a detailed demographic and wage analysis identifying the characteristics of the New York workers likely to be affected by the phased-in \$15 minimum wage.

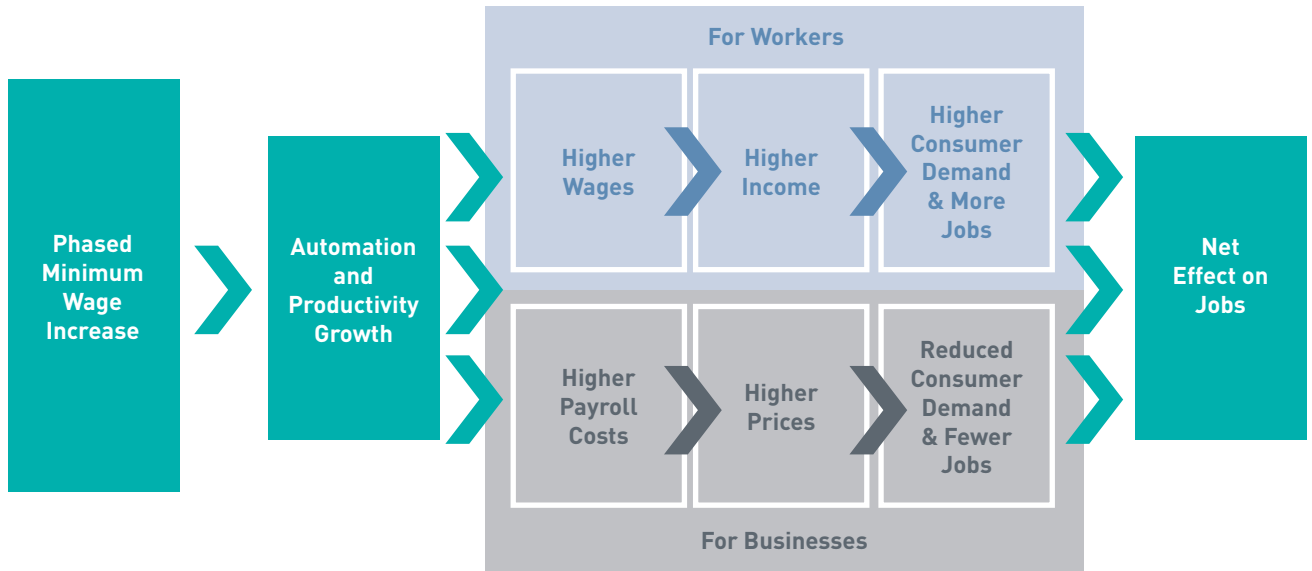
A business operations approach to gauging the impact of a higher minimum wage

Many factors besides wages affect total business costs, including the cost of materials, utilities, rent, and property taxes, for example. Labor costs average less than one-fourth of all operating costs, and the pay of executives, professionals and other high-paid workers often far overshadows the labor costs of minimum wage workers. When New York’s minimum wage is fully phased in, the higher minimum wage will have increased total private sector business operating costs, on average, by less than one percent. The impact of the higher minimum on operating costs for businesses likely to be affected ranges from two-tenths of one percent (0.2%) in retail trade and eight-tenths of one percent (0.8%) in food manufacturing, to 7.1 percent in restaurants.

Average Labor Costs as a Percent of Total Operating Costs: All Industries



FIGURE 1: Institute for Research on Labor and Employment, University of California, Berkeley Structural Minimum Wage Impact Model



Source: The Effects of a \$15 Minimum Wage Increase in New York State, 2016

The flow chart model (above), taken from the IRLE report (see text box, page 2), depicts the likely chain of events when the minimum wage increases, with the effects on workers on top, the effects on businesses at the bottom, and the net effect on jobs on the far right.¹

The net employment impact depends on a host of factors. A higher minimum wage contributes to higher payroll costs, pressuring businesses to be more productive, which may lead to expanded use of technology (automation) to maintain or increase output. A possible effect

on minimum wage workers is the reduction of hours worked; this possible reduction should be seen in the context of the net overall impact after factoring in the additional spending by minimum wage workers.

A higher wage rate can *reduce* some business costs. It can reduce absenteeism and employee turnover; that in turn will reduce recruitment and training costs and increase morale and worker productivity.² A more productive worker means a lower cost to produce something.

¹In the IRLE report, the authors cite research to support how they quantify each of the factors to estimate a net overall effect—in the interests of simplification, this overview will not detail all of the research they cite and the assumptions they make. The chart above simplifies some of the factors from the version in the ILRE report.

²Turnover in low-wage industries can range from 30-70 percent annually. The administrative and managerial costs of hiring are estimated to range from \$4,200 to \$5,900 per position in low-wage sectors. Reich, et.al., pp. 23-24. For the effects of higher wages in leading to higher productivity, see, e.g., Justin Wolfers and Jan Zilinsky, “Higher Wages for Low-Income Workers Lead to Higher Productivity,” in *Raising Lower-Level Wages: When and Why It Makes Economic Sense*, Peterson Institute for International Economics Briefing 2-15, 2015; and Zeynep Ton, “Why ‘Good Jobs’ are Good for Retailers,” *Harvard Business Review*, 2012. Reich also cites several studies indicating that higher pay can also improve worker morale, customer service and productivity. Reich, et.al., pp.24-25.

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Thus, a higher wage rate doesn't necessarily mean higher *total costs*, because there may be some savings from reduced turnover and from greater productivity. Studies cited in the Berkeley report estimate that about 20 percent of the increased costs from a minimum wage increase are offset by reduced turnover. These savings, in effect, help pay for the higher wage floor.³ Moreover, a higher wage rate can benefit the business bottom line by leading to improved customer service and satisfaction.

Since the state minimum wage increase affects all employers, there may be some latitude for businesses to slightly raise prices in the wake of an increase in the minimum, rather than reducing profits. And since labor costs average less than a quarter of operating costs, after factoring in savings from reduced turnover and higher productivity, the IRLE study estimates that prices would need to rise by only seven-tenths of one percent (0.7%), on average, to maintain profits. That's equivalent to 7 cents on something previously sold at \$10, or 70 cents on an item costing \$100.

The thrust of the impact on workers shown in the top half of the model (page 3) is that while there might be some slight reduction in employment as businesses experience and seek higher worker productivity, there will be a significant increase in wages for workers paid at or near the minimum wage level, which may positively impact employment as a result of increased consumer spending. The Economic Policy Institute estimated that roughly one-third of all New York City workers (1.44 million) would see, on average, a 23 percent increase in their annual wages, equivalent to \$4,900. Those

workers are likely to spend all of their increased wages, and that, in turn, will boost sales, including in local stores and service businesses where low-wage workers live. The increased sales—estimated at \$7 billion in expanded consumer spending in New York City⁴—translate into increased employment, offsetting any reduction in jobs or hours due to greater use of technology and resulting in the expansion of some higher-paying jobs.⁵

The IRLE study made reasonable assumptions for the various factors on both the business and worker impact sides and calculated the net overall effect. The result was a small positive net effect statewide—an increase of about 3,200 jobs, a result that would not change significantly if the assumptions were varied and that are a small fraction of the state's 0.85 percent average annual job growth over the past 25 years, a period including three recessions.

What will the impact be on workers typically considered to be at the end of the job queue, i.e., young adults, those with low literacy, or justice-involved? If there is considerable slack (i.e., high unemployment) in the local economy, then employers may seek out higher-skilled workers, but given the very low unemployment economy existing at present (recall the discussion in Brief #1), employers are likely to hire (or retain) young adults and others considered disadvantaged and seek ways to increase their skills and productivity. This is a general need even in the absence of a higher minimum. And keep in mind that there will be some new hiring resulting from the significant increase in consumer spending by low-wage workers.

³In cases like New York, however, where there is more than one significant increase, turnover savings are likely to be heavily concentrated in the early stages of the multi-year phase-in.

⁴New York State residents will earn an estimated \$14.4 billion in additional wages through 2021 as a result of the minimum wage increases, after reductions in public assistance and consumer spending from price increases borne by minimum wage workers. With New York City residents benefiting from approximately half the value of the wage increase—and research indicating that low-income individuals are more likely to spend additional wages—the City stands to benefit from approximately \$7 billion in expanded consumer spending by minimum wage workers through 2021.

⁵The IRLE study factors out the spending of workers living outside the state, and uses a standard economic model to estimate the portion of additional spending occurring within New York.

Positive bottom line for the local economy

The value of the IRLE report is that it analyzes how businesses actually operate, making explicit the various ways a minimum wage increase affects businesses, and that for most the wage impact is a very small fraction of total costs. In looking across the entire New York economy, the IRLE study concludes that the phased-in \$15 minimum wage “would effect a vast improvement in living standards for over a third of the workforce without generating a net adverse employment effect. It can do so through induced efficiencies (more automation, productivity gains, turnover savings) and slight price increases borne by all consumers.” That’s good news for businesses and for the local economy. And it’s very good news for a sizable fraction of the workforce whose wages will rise by an average of 23 percent. Prior to the recent period of New York minimum wage increases, wages for many low-wage workers had been stagnant since the early 2000s.

In evaluating the impact of raising the minimum wage on businesses, it is important to remember that businesses operate in a complex, competitive environment in which failure can result from many factors. Small businesses may not adjust well to shifting consumer preferences, or they may be hit with sharply rising commercial rents. Small retail shops may lose out to bigger businesses and online retail.⁶ When individual businesses fail, the slack almost always is taken up by other businesses, and with it the jobs.

Many large businesses recognizing the value of raising wages for low-wage workers

Even in the absence of a mandated minimum wage increase, the tightening labor market and the need to more effectively compete on the basis of customer service have led a growing number of businesses large and small to act on their own to raise wages for low-wage workers. There is a growing recognition on the part of businesses (and some investors) that higher wages are key to boosting consumer demand, reducing turnover, improving customer service, and enhancing profitability.⁷ Several large employers including Aetna, Gap, Ikea, JPMorgan Chase, Marshalls, McDonald’s, Starbucks, Target, T.J. Maxx, Walmart, and Whole Foods are raising wages as a result.

For well over a decade, wages for many workers have not kept pace with inflation and have lulled many employers into thinking that wage increases are not a key ingredient in business success. However, there is a growing management literature that finds that higher pay is directly associated with higher productivity and that businesses that pay higher wages than their competitors often pursue other practices that result in better performance by workers and better bottom-line results for businesses. For example, analyzing employment practices at several retail chains⁸, M.I.T. management professor Zeynep Ton found that the stores that perform the best pay higher

⁶Data from the Bureau of Labor Statistics’ [Business Employment Dynamics](#) indicate that 20 percent of small businesses fail within the first year of incorporation; 31 percent fail within the first two years; and 49 percent fail within five years.

⁷Lauren Weber, “Why Fund Managers Want Better HR,” The Wall Street Journal, September 8, 2015. <http://www.wsj.com/articles/why-top-fund-managers-want-better-hr-1441749764>

⁸Retail trade employs more workers who will benefit from the minimum wage increase in New York City than any other industry. David Cooper, Raising the New York state minimum wage to \$15 by July 2021 would lift wages for 3.2 million workers, EPI Briefing Paper, January 5, 2016.

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The Workforce Field Building Hub (The Hub) is a New York City-wide resource designed to unite and strengthen key stakeholders in the diverse and wide-reaching workforce development field. The Hub brings together key leaders from across the interdisciplinary and diverse New York City and national workforce community to identify common issues and solutions to build the field of workforce development. For more information, visit <http://thehub.workforceprofessionals.org>

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wages, provide better benefits, invest more in training their workers, have more advancement opportunities, and allow their employees more predictable schedules. We will have more to say on what Professor Ton calls “a good jobs strategy” in a future issue of *Monitoring the Minimum Wage*.

Conclusion

What’s important for business is the overall impact of a higher minimum wage on total costs and revenues and on the value produced by a better-paid workforce. At a forum on the minimum wage in New York City in early June this year, Bob Chory, President and CEO of Valente Bakery Supplies stated it succinctly: “What’s important is return on investment, not costs.”

“What’s important is return on investment, not costs.”

—**Bob Chory**, *Valente Bakery Supplies, Queens, New York City, June 7 2017.*

In assessing the net effect of raising the minimum wage to \$15 an hour, the bottom line effect for an individual company is the return on investment. A higher minimum wage pressures employers to be more innovative and efficient. For the economy as a whole, what’s important is the overall employment and business impact coupled with the well-being of low-wage workers and their families. On all counts, the \$15 minimum wage looks like a net positive for workers, businesses, and the local economy overall.

The next issue of *Monitoring the Minimum Wage* will look at the experiences of other cities following a significant minimum wage increase.