Economic Briefing: The Unintended Consequences of a $15 Minimum Wage

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A $15 Minimum Wage

Should we raise the minimum wage in Oregon? Not by a few cents from the current $9.25 an hour to keep up with inflation, but to $13.50 or even $15?

Momentum for a big increase is strong. The stated purpose, we are told, is to reduce poverty. But curiously, discussion of its true effectiveness as a poverty-fighting tool has been lacking. Are we being too quick to assume that a higher minimum wage will reduce poverty?

This briefing looks at the data and reveals that a $15 minimum wage may in fact do little or nothing to reduce poverty. Please consider the following three considerations

Consideration #1: The Myth of "Unintended Consequences"

"Unintended consequences" is a relatively new phrase. In the 1970's it appeared only three times in the New York Times. In the last ten years, it appeared 1,403 times. The phrase has become a policymakers' shrug of the shoulders, with the excuse "We had a good idea but things did not work out and now we are suffering from unintended consequences." But often, for us economists, the consequences are predictable. It is just that nobody bothered to ask at the outset what could go wrong, or more importantly, was it a good idea to start with?

So it is with the proposed $15 minimum wage. The concept is simple. There is too much poverty. Require employers to pay workers at least $15 an hour and reduce poverty. But the consequences—perhaps unintended, but nonetheless predictable—are concerning and may even backfire.

Consideration #2: True Focus of Increase is Not on the Poor

Only eight percent of Oregonians that would benefit from a $15 minimum wage currently come from families that are below the poverty threshold.[i] We know this because the US Census collects data on Oregon workers and their families.[ii] The other 92 percent are not poor—their 2014 median family income was $45,323. Raise the minimum to $15 and most of the increase will go to those that are not living in poverty. Thus, the policy does not focus on poverty.

By setting a $15 minimum wage, for one dollar going to a person living below the federal poverty threshold, over eleven would go to those that are not poor. As a poverty solution, a $15 minimum is an unfocused tool at best.

Consideration #3: New Disposable Income Will Not Offset Costs to Businesses

What is the Increase in Disposable Income?

"Disposable" income is the money left over after paying taxes and getting tax credits. Disposable income is the money that gets put into pockets for spending. So how much new disposable income would workers have? And how much new cost would be imposed on businesses?

A major argument in favor of raising the minimum wage posits that putting more money in workers' pockets will offset the imposed costs on local businesses. The hypothesis is that workers would spend their additional disposable income at local businesses, leaving the economy no worse for the wear.

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Consider an example of a single parent family with one child. If they work 2,000 hours in a year (about 38 hours a week), were paid the current minimum wage of $9.25, they would earn $18,500 a year. Assume further that they pay $2,000 in childcare expenses. How much money would they take home? And how much would they if the minimum wage were $15?

To answer these questions, we ran the example through H&R Block 2014 tax software.[iii] At $18,500 in wages, our family pays no federal income tax. Rather, they get $4,194 in earned income and childcare tax credits. They would pay state income tax, even after earning some tax credits, and pay FICA and Medicare. Their disposable income is $21,021.

	@ $9.25	@ $15.00	Change
Annual wage	$18,500	$30,000	$11,500
Federal tax benefit	4,194	1,590	(2,604)
State income tax	(258)	(1,278)	(1,020)
FICA	(1,147)	(1,860)	(713)
Medicare	(268)	(435)	(167)
Disposable income	$21,021	$28,017	$6,996

Changing the wage rate from $9.25 to $15.00 and running the same example through H&R Block shows taxes going up and tax credits declining. At a $30,000 wage, disposable income is $28,017.

What the data show is that although annual wages increase $11,500 when increasing the minimum wage, disposable income for the single parent family with one child goes up much less—by $6,996. Nearly four out of every ten dollars in higher pay from raising the minimum wage is lost to tax effects.

How much of that $6,996 gets spent in Oregon? The economic impact model of Oregon says 70½ percent for families earning between $10,000 and $35,000 a year.[iv] That works out to $4,932 in local spending.

What is the Increased Cost to Employers?

Payroll taxes have a substantial impact on employer costs. Consider again an employee working 2,000 hours a year doing the same job as before, but getting $15.00 instead of $9.25. Their employer has to come up with more money to cover FICA, Medicare, unemployment insurance, and TriMet taxes (in Portland). All are mandatory and based on wages. As shown in the table below, total costs for the employer increase $12,808.

Employer Cost	Annual
Wages paid	$11,500
FICA	713
Medicare	167
Unemployment insurance	$345
TriMet payroll tax	$83
Total	$12,808

The employer also has less money to spend and invest. So too would the employer's customers, some of whom are poor, should wage hikes be paid for through price increases.

Conclusions

The data show only eight percent of those benefitting from a $15 minimum wage are poor and the median family income of the other 92 percent is $45,323. Furthermore, a fulltime worker seeking a raise from $9.25 to $15 would lose almost 40 percent of it to tax increases. Of what is left, they would spend only $4,932 locally. Meanwhile, their employer would pay $12,808 more—covering it by reducing spending and passing costs on to customers. All are reasons to suspect that a $15 minimum wage is an ineffective tool for reducing poverty.

Income cannot be generated by state mandate. Rather, Oregon needs incentives for productivity, education, job growth, and individuals to start businesses.

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[i] http://www.census.gov/hhes/www/poverty/about/
[ii] U.S. Census Bureau, 2014 Current Population Survey obtained using IPUMS-CPS, University of Minnesota. Oregon civilian employees age 15 and older.
[iii] Downloaded Oregon and federal tax return software from http://www.hrblock.com/tax-software/
[iv] IMPLAN 2013 Oregon State model.