CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

March 26, 2014

S. 1737
Minimum Wage Fairness Act

As introduced in the Senate on November 19, 2013

SUMMARY

S. 1737 would amend the Fair Labor Standards Act (FLSA) to increase the federal minimum wage in three steps from $7.25 per hour to $10.10 per hour, and to adjust the wage annually thereafter to account for inflation. In addition, the bill would increase the federal minimum cash wage for workers who receive tips by gradually raising that wage until it equals 70 percent of the federal minimum wage for other workers. Finally, S. 1737 would amend the Internal Revenue Code to extend through 2016 an increased limitation on the amount of investment that firms can immediately deduct from their taxable income—a limitation that mostly affects small- to medium-sized businesses.

Increasing the minimum wage would have various direct and indirect effects on the federal budget. It would affect the federal budget directly by increasing the wages that the federal government paid to a small number of hourly employees and indirectly by boosting the prices of some goods and services purchased by the government. Federal spending and taxes would also be indirectly affected by increases in income for some people and reductions in income for others. In a previous analysis, taking into account both the direct and indirect effects on the federal budget, CBO concluded that it is unclear whether the net effect for the coming decade would be a small increase or a small decrease in budget deficits.[1]

However, cost estimates that are produced by CBO and used for enforcing Congressional budget rules typically reflect a long-standing convention that macroeconomic variables, such as nominal output and the average price level, remain fixed at the values that they are projected to reach under current law. This cost estimate does not incorporate the effects that an increase in the minimum wage would probably have on the economy and any effects on the budget that would result from them. Instead, the estimate includes only the direct effects of raising the minimum wage on the wages paid by the federal government, as well as the direct effects of the change in the tax code. Those effects are the following:

1. See Congressional Budget Office, *The Effects of a Minimum-Wage Increase on Employment and Family Income* (February 2014), www.cbo.gov/publication/44995.

- Implementing the bill would increase spending subject to appropriation by $2 million over the 2014-2024 period, CBO estimates, assuming the availability of appropriated amounts.

- Enacting the bill would increase direct spending by the United States Postal Service (USPS) by $2 million over the 2014-2024 period, CBO estimates. Spending for the USPS is classified as off-budget and is not subject to pay-as-you go procedures.

- The staff of the Joint Committee on Taxation (JCT) estimates that enacting the bill would decrease revenues by $5 billion over the 2014-2024 period as a result of the provision related to business tax deductions for investment. Because the bill would affect revenues, pay-as-you-go procedures apply.

CBO has determined that the nontax provisions of the bill would impose intergovernmental and private-sector mandates, as defined in the Unfunded Mandates Reform Act (UMRA), on employers whose workers are covered under FLSA. Specifically, public and private employers would be required to pay some of the covered workers higher wages under the bill than they will pay under current law. CBO estimates that the aggregate annual costs to comply with the mandates for state, local, and tribal governments and the private sector would significantly exceed the thresholds established in UMRA in each year beginning in fiscal year 2015. (The thresholds in 2014 are $76 million for intergovernmental mandates and $152 million for private-sector mandates; both thresholds are adjusted annually for inflation.)

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary impact of S. 1737 is shown in the table below. The legislation would affect tax revenues, as well as spending by those departments and agencies that have employees earning less than the proposed minimum wages.

BASIS OF ESTIMATE

For purposes of this estimate, CBO assumes the legislation will be enacted by July 1, 2014. Under that assumption, the minimum wage would rise from $7.25 to $8.20 on January 1, 2015, to $9.15 on January 1, 2016, and to $10.10 on January 1, 2017. The minimum wage would be adjusted for inflation as measured by the consumer price index beginning in 2018. The tax provisions of S. 1737 would apply to taxable years from 2014 through 2016.

	By Fiscal Year, in Millions of Dollars												
	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2014-2019	2014-2024
CHANGES IN DIRECT SPENDING													
Estimated Budget Authority[a]	*	*	*	*	*	*	*	*	*	*	*	1	2
Estimated Outlays[a]	*	*	*	*	*	*	*	*	*	*	*	1	2
CHANGES IN REVENUES													
Estimated Revenues	-7,019	-12,294	-9,590	917	8,559	5,629	3,904	2,531	1,367	672	356	-13,798	-4,968
NET INCREASE OR DECREASE (-) IN THE DEFICIT FROM CHANGES IN DIRECT SPENDING AND REVENUES													
Impact on Deficit	7,019	12,294	9,590	-917	-8,559	-5,629	-3,904	-2,531	-1,367	-672	-356	13,799	4,970
CHANGES IN SPENDING SUBJECT TO APPROPRIATION													
Estimated Authorization Level	*	*	*	*	*	*	*	*	*	*	*	1	2
Estimated Outlays	*	*	*	*	*	*	*	*	*	*	*	1	2

Sources: CBO and the staff of the Joint Committee on Taxation.

Note: * = less than $500,000.

a. Direct spending for the U.S. Postal Service; all such spending is classified as off-budget.

Cost estimates produced by CBO and JCT and used for enforcing Congressional budget rules typically reflect the convention that macroeconomic variables, such as nominal output and the average price level, remain fixed at the values that they are projected to reach under current law. That is a long-standing convention—one that has been followed in the Congressional budget process since it was established in 1974 and by JCT since the early 1960s. In producing this cost estimate, CBO and JCT did not incorporate the effects that an increase in the minimum wage would probably have on the economy.

In a lengthy analysis published in February, CBO considered the effects of a minimum-wage increase on the federal budget incorporating macroeconomic effects. The agency wrote:[2]

> "An increase in the federal minimum wage would directly affect the federal budget by requiring the government to increase wages for a small number of hourly federal employees. A minimum-wage increase would also indirectly affect the budget by boosting the prices of some goods and services purchased by the government. Most of those added costs for wages, goods, and services would need to be covered by discretionary appropriations, which are capped through 2021 under current law. If the caps were not adjusted, federal budget deficits would not be affected by the higher

2. See pages 13-14 of *The Effects of a Minimum-Wage Increase on Employment and Family Income*.

costs, but the benefits and government services that could be provided under the existing caps would be reduced. If, instead, lawmakers adjusted the caps to cover the higher costs, and if future appropriations equaled those higher caps, then deficits would be larger."

> "In addition, an increase in the federal minimum wage would indirectly affect the federal budget by changing people's income—raising real income for some workers while reducing the real income of people who would be jobless because of the minimum-wage increase, of business owners, and of consumers facing higher prices. As a group, the workers receiving an earnings increase would pay more in taxes and receive less in benefits than they would have otherwise, reducing the federal budget deficit; however, the workers, business owners, and consumers with reduced income would pay less in taxes and receive more in benefits, increasing the deficit."

> "CBO anticipates that the increases in income would be larger than the decreases in income for a few years after an increase in the minimum wage but would be smaller thereafter… CBO anticipates that the effective marginal tax rate—that is, the combination of increased taxes and decreased benefits for each additional dollar of income—for the increases in income would probably be slightly larger than the effective marginal tax rate for the decreases in income. Combining those factors, CBO concludes that the net effect on the federal budget of raising the minimum wage would probably be a small decrease in budget deficits for several years but a small increase in budget deficits thereafter. It is unclear whether the effect for the coming decade as a whole would be a small increase or a small decrease in budget deficits."

As noted above, however, this cost estimate does not incorporate the effects that an increase in the minimum wage would probably have on output and prices. The estimate also does not include the largely offsetting indirect effects on the budget that would result from increases in income for some people and decreases in income for others. CBO was not able to assess how accounting for those increases and decreases might affect the estimated budgetary effects of increasing the minimum wage, and accounting for those factors while also assuming that nominal output and the average price level remain fixed would not be very informative. Therefore, this estimate includes only the direct effects of raising the minimum wage on the wages paid by the federal government, as well as the direct effects of the change in the tax code.

Spending Subject to Appropriation

Based on information from the Office of Personnel Management, CBO estimates that fewer than 4,000 workers are employed by the federal government at hourly rates below $10.10. CBO expects that, over time, hourly wages will increase under current law, thus reducing the effect of the proposed increase in the minimum wage.

Raising wages for the affected workers in step with the provisions of S. 1737 would increase discretionary costs by less than $500,000 per year over the 2014-2024 period, CBO estimates, for a cumulative cost of $1 million over the 2014-2019 period and $2 million over the 2014-2024 period. That estimate represents an incremental increase in wages for federal workers above the increases that are projected under current law.

Most of those added costs for wages would need to be covered by discretionary appropriations, which are capped through 2021 under current law. If the caps were not adjusted, federal budget deficits would not be affected by the higher costs, but the benefits and government services that could be provided under the existing caps would be reduced slightly. If, instead, lawmakers adjusted the caps to cover the higher costs, and if future appropriations equaled those higher caps, then deficits would be slightly larger, all else being equal.

Direct Spending

Based on information from the Postal Service, CBO estimates that fewer than 1,000 workers are employed by that agency at hourly rates below $10.10. CBO expects that, under current law, some of those individuals will receive pay increases to hourly rates above $10.10 within the next several years.

Raising wages for the affected workers in step with the provisions of S. 1737 would increase direct spending by less than $500,000 per year over the 2014-2024 period, with a cumulative cost of about $1 million over the 2014-2019 period and $2 million over the 2014-2024 period. (Because the Postal Service does not require an annual appropriation each year to fund its operations, its spending is considered mandatory.)

Revenues

The legislation would extend through 2016 (and apply retroactively to the beginning of 2014) the increased limitation on the amount of investment that can be immediately deducted by firms from their taxable income. As a result, the full costs of up to $500,000 in investment of certain equipment could be immediately deducted rather than being deducted incrementally over time. The benefit of that immediate expensing would phase out for firms that have total qualifying investment in a year exceeding $2 million. According to JCT's estimates, that provision would decrease revenues from 2014 through 2016, and increase them thereafter. All told, revenues would be reduced by $7 billion in 2014 and by $5 billion over the 2014-2024 period.

PAY-AS-YOU-GO CONSIDERATIONS

The Statutory Pay-As-You-Go Act of 2010 establishes budget-reporting and enforcement procedures for legislation affecting direct spending or revenues. The net changes in outlays and revenues that are subject to those pay-as-you-go procedures are shown in the following table. Only on-budget changes to outlays or revenues are subject to statutory pay-as-you-go procedures. Thus, for S. 1737, only the changes in revenues are subject to those procedures.

CBO Estimate of Pay-As-You-Go Effects for S. 1737 as introduced in the Senate on November 19, 2013

	By Fiscal Year, in Millions of Dollars												
	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2014-2019	2014-2024
NET INCREASE OR DECREASE (-) IN THE ON-BUDGET DEFICIT													
Statutory Pay-As-You-Go Impact	7,019	12,294	9,590	-917	-8,599	-5,629	-3,904	-2,531	-1,367	-672	-356	13,798	4,968

INTERGOVERNMENTAL AND PRIVATE-SECTOR IMPACT

CBO has determined that the nontax provisions of S. 1737 would impose intergovernmental and private-sector mandates, as defined in UMRA, on employers whose workers are covered under the Fair Labor Standards Act. Specifically, public and private employers would be required to pay some of the covered workers higher wages under the bill than they will pay under current law. The cost of the mandate would be the additional amount paid in wages to those workers to meet the new minimum-wage requirements.

CBO estimated the cost of the mandate by using monthly data from the Census Bureau's Current Population Survey to project the distribution of workers' hourly wages under current law. In projecting hourly wages, CBO accounted for prospective increases in some states' minimum wages, including both changes scheduled in current state laws and changes projected on the basis of how states have changed their minimum wages in the past. CBO then identified workers (including workers whose compensation depends heavily on tips) who would be covered by FLSA and who, by CBO's projection, would be paid hourly wages lower than the schedule of minimum wages set by the bill.[3]

CBO estimates that public and private employers who are subject to the mandate would face costs that significantly exceed the thresholds established in UMRA for each year beginning in fiscal year 2015. (The thresholds in 2014 are $76 million for intergovernmental mandates and

3. For more information about CBO's methodology for analyzing the effects of increasing the minimum wage, see *The Effects of a Minimum-Wage Increase on Employment and Family Income.* For this analysis of the costs of the mandates, CBO excluded workers who would not be covered by FLSA, including workers in most small firms, workers in occupations generally exempt from FLSA, and teenagers who would be in their first 90 days of employment. Those exclusions differ from the analysis in CBO's February report, for which CBO included workers who are not covered by FLSA but who are expected by CBO to be affected by an increase in the minimum wage because their hourly wages tend to be as concentrated near the minimum wage as are the wages of workers covered by FLSA.

$152 million for private-sector mandates; both thresholds are adjusted annually for inflation.) For example, in fiscal year 2017, when the federal minimum wage would be $10.10 per hour under the legislation, state, local, and tribal employers would be required to pay their covered workers an estimated $1 billion more in wages than they would pay under current law, and private employers would be required to pay their covered workers an estimated $15 billion more in wages than they would pay under current law.[4]

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4. The sum of estimated mandate costs for governmental employers ($1 billion) and private employers ($15 billion) is much less than the estimated increase in earnings for low-wage workers resulting from the same increase in the minimum wage ($31 billion) that CBO reported in *The Effects of a Minimum-Wage Increase on Employment and Family Income.* CBO's estimate of the increase in earnings for low-wage workers is larger than the estimated mandates costs principally for two reasons. First, some workers who would not be covered by FLSA (and therefore would not have a mandated increase in their wages) would nevertheless probably experience an increase in their wages. Specifically, the estimated increase in earnings in the February report includes earnings not only of workers who would be covered by FLSA and would earn less than $10.10 per hour under current law, but also of some workers who would be earning less than $10.10 who are not subject to FLSA and some workers with earnings slightly more than $10.10 whose wages would probably also rise. Second, the estimate of increased earnings in the February report refers to the second half of calendar year 2016, whereas the estimate here refers to fiscal year 2017. Specifically, under current law, CBO estimates that wages will be higher in fiscal year 2017 than in the second half of 2016; as a result, employers would need to increase wages by a smaller amount, on average, in fiscal year 2017 to pay their workers $10.10 per hour. Additionally, the minimum wage would rise later under the provisions of S. 1737 than was assumed in the February report. As a result, employers would be required to pay $9.15 per hour rather than $10.10 per hour for the first three months of fiscal year 2017.