



**CONGRESSIONAL BUDGET OFFICE
PRIVATE-SECTOR MANDATE STATEMENT**

March 26, 1998

**S. 1805
Fair Minimum Wage Act of 1998**

*As introduced and referred to the Senate Committee on Labor and Human Resources
on March 19, 1998*

SUMMARY

S. 1805 would amend the Fair Labor Standards Act of 1938 (FLSA) to increase the minimum wage rate under the Act from \$5.15 per hour to \$5.65 per hour on January 1, 1999, and to \$6.15 per hour on January 1, 2000.

PRIVATE-SECTOR MANDATES CONTAINED IN BILL

S. 1805 contains a mandate on private-sector employers covered by the FLSA. It would require those employers to pay a higher minimum wage rate than they are required to pay under current law.

ESTIMATED DIRECT COST TO THE PRIVATE SECTOR

CBO's estimate of the direct cost of the private-sector mandate in S. 1805 is displayed in the following table.

DIRECT COST OF PRIVATE-SECTOR MANDATE

Provision	Fiscal Year (dollars in billions)				
	1999	2000	2001	2002	2003
Increase the minimum wage rate	2.7	7.4	7.9	7.0	6.2

BASIS OF THE ESTIMATE

S. 1805 specifies that the minimum wage is to increase from \$5.15 to \$5.65 per hour on January 1, 1999, and to \$6.15 on January 1, 2000. Other sections of the FLSA providing different rules for certain workers and employers, including the provision permitting employers to pay teenagers \$4.25 per hour during the first 90 consecutive days of employment, would not change.

To estimate the direct cost to private employers, information was used on the number of workers whose wages would be affected in January 1999 and subsequent months, the wage rates these workers would receive in the absence of the enactment of the proposal, and the number of hours for which they would be compensated.

The estimate was made in two steps. CBO used data from the Current Population Survey (CPS) to estimate how much it would have cost employers to comply with the mandate had they been required to do so in early 1998. Second, these estimates were then used to project the costs to employers beginning in January 1999, taking into account the expected decline in the number of workers in the relevant wage range. The remainder of this section discusses the way this estimate was constructed and limitations of the data and methods.

The methods used for this estimate are similar to those used for CBO's estimates of proposals made in 1996, the most recent year in which bills to increase the federal minimum wage rate were considered on the floor of the Senate and the House. Unlike in 1996, CBO only has information about the number of workers in the relevant wage range for a very short time period since the current minimum wage rate became effective. In preparing the estimates in 1996, CBO was able to use data from several years when the minimum wage was at the then-existing rate of \$4.25 per hour. The current rate of \$5.15 per hour was implemented in September 1997. As more information becomes available, this estimate might need to be revised.

Estimates from the Current Population Survey

Data on hourly wage rates contained in the January 1998 CPS provide CBO's estimate of the number of private-sector workers in that month who were paid in the relevant range. At that time, about 2.2 million workers in the private sector were paid exactly \$5.15 per hour and an additional 9.5 million workers were paid between \$5.16 and \$6.14 per hour. (About 1.5 million additional workers reported being paid \$5.00 per hour; as discussed below, it is assumed that these workers were also covered by the \$5.15 minimum wage and were

misreporting their wage rates.) Roughly one-quarter of the workers in the relevant wage range were teenagers. Based on information from the Bureau of Labor Statistics, it is assumed that about 30 percent of those teenagers were in their first 90 days of employment with their current employer and therefore not covered by the increase in the minimum wage.¹

CBO estimates that if the workers in the private sector who had been paid between \$5.00 and \$5.64 per hour in January 1998 had been paid \$5.65 instead (with no change in the number of hours worked), their employers would have paid them approximately \$300 million in additional wages in that month. If the workers who had been paid between \$5.00 and \$6.14 had been paid \$6.15, their employers would have incurred an additional wage bill of about \$900 million in that month. Moreover, employers would have had to pay the employers' share of the payroll taxes on these additional wages; these taxes are included in CBO's estimate of the total direct cost of the mandate.

Applying the Estimates from the CPS to the Projection Period

The monthly cost to employers of the proposed increases in the minimum wage would be smaller in the future because the number of workers in the affected range will decline. For example, during the eight-year period starting in 1981 when the minimum wage remained at \$3.35 per hour, the number of workers paid exactly that rate declined from 4.2 million to 1.8 million, as market forces and increases in state minimum wage rates raised the level of wages paid. In 1996, CBO used data from the March 1992 and March 1995 CPS to estimate that the cost of complying with a minimum wage of \$5.15 per hour would have fallen by almost 40 percent over this three-year period, or about one percent per month.

CBO assumes that the direct mandate cost would continue to decrease at this rate throughout the projection period. Thus, the monthly cost of raising the minimum wage to \$5.65 in January 1999 would be roughly 87 percent of the cost estimated using the January 1998 data. The estimated cost of raising the minimum wage to \$6.15 in January 2000 would be about 79 percent of the cost of doing so in January 1998.

Estimates for each fiscal year were then made by aggregating the monthly costs. The estimate for fiscal year 1999 is the smallest because that period only includes an increased minimum wage for nine months. The estimate for 2000 includes the cost of a \$5.65 minimum wage for three months and a \$6.15 minimum wage for nine months. The estimate of the direct cost to the private sector is highest for 2001, when all twelve months would be at \$6.15 per hour.

¹ This estimate is derived from information on job tenure, by age, provided by the Bureau of Labor Statistics, based on supplemental questions included in the February 1996 Current Population Survey.

Limitations

Estimates of the direct cost of this mandate are uncertain for at least two reasons. First, the main source of data -- the January 1998 CPS -- is subject to sampling error and other problems when used for this purpose. For example, CBO assumed that the workers who reported being paid \$5.00 per hour after the minimum wage had risen to \$5.15 were actually earning \$5.15 because there is no evidence that compliance with the Fair Labor Standards Act fell.² The wage rates of other low-wage workers -- some of the workers who reported being paid below \$5.00 per hour and some of the workers not paid on an hourly basis -- would also be affected by an increase in the statutory minimum.³ Second, there is no solid basis for projecting the future number of workers who would have wage rates in the relevant range, their precise wage rates, nor the number of hours they would work under current law. The annual decline estimated from the 1992-1995 period could turn out to be too rapid or too slow.

INDIRECT EFFECTS OF AN INCREASE IN THE MINIMUM WAGE

An increase in the minimum wage rate from \$5.15 to \$6.15 would require employers to raise the wage rates paid to the lowest-paid workers covered by the FLSA by 19 percent, and would require employers to raise the wages of workers in the range between the old and the new statutory rates by smaller amounts. As under current law, employers could still pay teenage workers \$4.25 per hour during their first 90 calendar days.

Economists have devoted considerable energy to the task of estimating how employers would respond to such a mandate. Although most economists would agree that an increase in the minimum wage rate would cause firms to employ fewer low-wage workers (or employ them for fewer hours), there is considerable disagreement about the magnitude of the reduction. It has proven difficult to isolate the effects of past changes in the minimum wage. Moreover, the estimates from such analyses are hard to apply to future changes.

Based on CBO's review of a number of these studies, a plausible range of estimates for illustrating the potential losses is that a 10 percent increase in the minimum wage would result in a 0.5 percent to 2 percent reduction in the employment level of teenagers and a

² Staff within the Department of Labor's Employment Standards Administration, the agency responsible for enforcing the FLSA, report no increase in the number of complaints filed since the minimum wage increased to \$5.15.

³ In January 1998, there were almost 2 million workers who reported being paid an hourly wage rate of less than \$5.00. Some workers, such as employees in retail firms whose gross volume of sales is less than \$500,000 are not covered by the minimum wage, while others, such as certain tipped workers, are covered but can be paid a lower wage rate.

smaller percentage reduction for young adults (ages 20 to 24).⁴ These estimates would produce employment losses for an increase in the minimum wage of the extent provided in this bill of roughly 100,000 to 500,000 jobs. The individuals whose employment opportunities would be reduced are likely to include the least-skilled job-seekers who might benefit most from the work experience.

This range of employment impacts is the same as CBO estimated two years ago when Congress was considering a 21 percent (\$0.90 per hour) increase in the minimum wage.⁵ At that time, the low end of the range seemed more realistic because the number of workers in the relevant wage range and the size of the minimum wage relative to the average wage were relatively low. This time, however, those special considerations do not apply because less time has elapsed since the most recent increase in the minimum wage. About 50 percent more workers are in the affected wage range now than were in the relevant wage range when the 1996 legislation was being considered. Likewise, the minimum wage is currently about 41 percent of the average hourly earnings of production or nonsupervisory workers in the private sector, compared with about 36 percent just before the 1996 legislation was enacted.

But two additional differences from the situation that existed in 1996 could reduce employment impacts. First, the labor market is exceptionally tight, with the total unemployment rate at 4.6 percent and the teenage unemployment rate at 14.7 percent (February 1998). In 1996, the total unemployment rate was nearly one point higher and the teenage unemployment rate was two points higher. Second, the most recent increase in the minimum wage amended the FLSA to permit employers to pay teenagers \$4.25 per hour for the first 90 days, and the current bill would not change this provision. The literature on which the estimates reported above are based did not reflect such a differential. Presumably, the differential could result in fewer employment losses for teenagers, more losses for adults, and fewer losses overall. Although recent data indicate that few employers are using the option, its availability could cushion employment losses if labor markets weakened.

In addition to its effect on employment levels, an increase in the minimum wage could have many other economic impacts. For example, one consequence that has received considerable attention is its potential effects on the earnings of low-wage workers. CBO estimates that

⁴ See, for example, Alison J. Wellington, "Effects of the Minimum Wage on the Employment Status of Youths: An Update," *Journal of Human Resources*, Vol. XXVI, No. 1 (Winter 1991), pp. 27-46, Charles Brown, "Minimum Wage Laws: Are They Overrated?" *Journal of Economic Perspectives*, Vol. 2, No. 3 (Summer 1988), pp. 133-145, David Card and Alan B. Krueger, *Myth and Measurement: The New Economics of the Minimum Wage* (Princeton University Press, 1995), and Marvin H. Koster, editor, *The Effects of the Minimum Wage on Employment* (AEI Press, 1996).

⁵ On March 25, 1996, CBO provided an estimate of the cost to the private sector of S. 413, which would have increased the minimum wage rate in two annual steps, from \$4.25 per hour to \$5.15 per hour. That bill did not include the youth differential and other special provisions that were contained in the legislation enacted later that year.

the direct effect of the proposed increase would be to increase the aggregate earnings of workers who would otherwise have received between \$5.15 and \$6.14 per hour by over \$7 billion in 2001. An indirect effect of the increase in the minimum wage might be that employers would also voluntarily raise the wage rates of workers who were already being paid just above the new rate in order to maintain differentials (the "spillover effect").

PREVIOUS CBO ESTIMATE

On March 3, 1998, CBO issued an estimate of S. 1573, which would increase the minimum wage rate in three annual steps to \$6.65 per hour and then would adjust the minimum wage thereafter to reflect changes in the Consumer Price Index. The current estimate of the direct cost to the private sector is based on the same methodology.

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