CONGRESSIONAL BUDGET OFFICE
U.S. Congress
Washington, DC 20515

December 29, 2006

Honorable William "Bill" M. Thomas
Chairman
Committee on Ways and Means
U.S. House of Representatives
Washington, DC 20515

Dear Mr. Chairman:

I am pleased to respond, in the attachment to this letter, to your questions about the potential effects on government revenues and outlays that could result from enactment of an increase in the federal minimum wage rate from $5.15 to $7.25 per hour.

In addition, at the request of Congressman McKeon, CBO has prepared a cost estimate (dated December 29, 2006) for H.R. 2429, the Fair Minimum Wage Act of 2005, which would raise the minimum wage to $7.25 in three steps over a two-year period. A copy of that estimate is also attached.

If you require additional information about the effects of increases in the minimum wage, CBO will be pleased to provide it. The staff contacts are Paul Cullinan, Ralph Smith, and Mark Booth.

Sincerely,

Donald B. Marron

Donald B. Marron
Acting Director

Attachments

cc: Honorable Charles B. Rangel
Ranking Democrat

Honorable Howard P. “Buck” McKeon
Chairman
House Committee on Education and the Workforce

Honorable George Miller
Ranking Minority Member

Honorable Jim Nussle
Chairman
House Committee on the Budget

Honorable John M. Spratt Jr.
Ranking Member

Honorable Charles E. Grassley
Chairman
Senate Committee on Finance

Honorable Max Baucus
Ranking Democratic Member

Honorable Mike Enzi
Chairman
Senate Committee on Health, Education,
Labor, and Pensions

Honorable Edward M. Kennedy
Ranking Member

Honorable Judd Gregg
Chairman
Senate Committee on the Budget

Honorable Kent Conrad
Ranking Member

Congressional Budget Office

Responses to Questions Posed by Congressman Thomas About the Effects of Increasing the Federal Minimum Wage

December 29, 2006

Question. How many workers currently earning under or just above $7.25 an hour would be affected? Does CBO believe that a higher minimum wage will result in increased unemployment among this group?

Answer. According to data from the Current Population Survey, in October 2006, there were approximately 8.4 million workers usually paid on an hourly wage basis whose wage rate was between $5.15, the current federal minimum wage rate, and $7.25; two-thirds of them were paid more than $6.00 per hour.

The number of workers at or just above the federal minimum wage rate has been declining and is expected to continue to decline because of market forces and actions taken by many states. As of October 2006, 20 states and the District of Columbia had laws that required employers covered by their legislation to pay wage rates above $5.15 per hour. In 2007, eight more states will fall in that category. Some states, including California and Massachusetts, will have minimum wage rates above $7.25. Thus, the number of people that would be directly affected by an increase in the federal minimum wage rate and the magnitude of the wage adjustments that would be required of employers are expected to diminish over time.

The potential employment and unemployment impacts of raising the federal minimum wage rate to $7.25 per hour are difficult to predict, but are likely to be small. 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, there is considerable disagreement about the magnitude of the reduction. The main reason for that disagreement is the difficulty in distinguishing the effects on employment that were attributable to past changes in the minimum wage from those that were attributable to other changes in the labor market.

Moreover, the results of such analyses are difficult to apply to future changes because labor market conditions will be different. Many of the attempts to estimate the employment impacts of increases in the minimum wage were based on data from periods in which the federal minimum wage was much higher, as a percentage of average wages, than it is now or will be when any proposed increases would take effect. Likewise, the number of people paid at the federal minimum wage rate is much smaller now than it was prior to previous increases even though the labor force has grown significantly.

Employers could respond to an increase in the federal minimum wage in many different ways. Some would reduce the number of workers they employed or cut back on the number of hours worked by some of their employees. Because many of the workers in the affected wage range are on part-time schedules, reducing the hours of employment might be easier to do than it would be if all workers were employed on fixed eight-hour schedules.

Other ways that employers might respond to an increase in the federal minimum wage would not involve adjustments in employment levels or hours. Employers might screen job applicants more closely to select employees from whom they would expect higher productivity. Some employers might reduce fringe benefits for their employees. Some employers might attempt to pass along at least a portion of the additional payroll costs to their customers by raising prices. They might be successful in doing so if their competitors were also faced with higher labor costs because of the increase in the minimum wage.

Any reductions in the growth in employment resulting from such an increase in the minimum wage rate would not necessarily result in a corresponding increase in unemployment—that is, the number of people actively seeking work. The impact on the level of unemployment would also depend on how the changes in work opportunities resulting from an increase in the minimum wage rate affected people's decisions about participating in the labor force.

Question. Does CBO expect there to be any increased or decreased spending on work support programs such as the Earned Income Tax Credit, Medicaid, or Food Stamps? Is there an expected increase or decrease in the number of people participating in these anti-poverty programs as a result of higher wages resulting from the minimum wage?

Answer. The increases in the minimum wage on the order of magnitude suggested in your letter could affect federal spending, but the Congressional Budget Office (CBO) judges that those effects would be small. Moreover, whether those impacts would be an increase or decrease in spending is uncertain because the result would depend on the income and family characteristics of the affected individuals. Some workers would see their incomes increased, but others might see their work hours and earnings decline (or sometimes eliminated completely) as employers responded to the increase in the minimum wage. CBO expects that, in many cases, those groups of workers would have similar characteristics and therefore similar tendencies to participate in public programs. For those workers newly unemployed, increased participation in assistance programs would generate significant additional costs on a per-case basis, but decreased costs for workers with increased earnings would offset most or all of that effect.

The majority of minimum-wage workers do not receive any benefits under the Earned Income Tax Credit (EITC), Food Stamp program, or Medicaid. Those eligible for EITC payments could receive either higher or lower payments depending on whether or not they were in the "phase-in" or the "phase-out" income ranges. Workers would lose EITC payments if they were in the phase-out range and received higher earnings, and they would gain EITC payments if they were in the phase-in range and received higher earnings, within limits. CBO's analysis suggests that more affected workers are in the phase-out range than in the phase-in range. However, the implicit tax rate for EITC recipients in the phase-out range is generally much lower than the rate of benefit accrual for recipients in the phase-in range. As a result, CBO's preliminary analysis suggests that the phase-in and phase-out effects would virtually offset each other and total EITC payments would be little changed.

Food Stamp benefits would fall for some workers, but could rise for others if they were among those in the labor force who saw their work hours decline. Similarly, some Medicaid recipients would reach income levels that would make them ineligible for that coverage, while others whose work hours were diminished might become eligible.

Question. Will there be significant increases in the amount of payroll or income taxes collected as a result of the increased income from affected workers?

Answer. CBO's estimate of the potential effects of an increase in the minimum wage on federal revenues is similar to that for spending—the impact would be small and of indeterminate direction. The effective tax rates for workers whose income would rise are not likely to be very different from those who might see their hours and earnings decreased. Those effective tax rates reflect payroll taxes (for Social Security, Medicare, and Unemployment Insurance) and income taxes.

Question. What effect will the increased minimum wage have on the unemployment insurance program? Does CBO expect that state unemployment payroll taxes will need to be increased or that unemployment benefit payments will increase as a result of any unemployment resulting from the increase in the minimum wage?

Answer. CBO estimates that increases in the minimum wage would have a negligible effect on the unemployment insurance (UI) program. Unemployment benefits might rise slightly from any increase in unemployment that might ensue, but only a very small share of minimum-wage workers end up qualifying for benefits. Initially, taxes under the program could rise or fall depending on what happened to earnings under the annual cap on taxable wages. Moreover, to the extent that the balances in the state UI accounts deviated from a state's desired position, the state would adjust its tax rates and benefit provisions to offset those deviations, CBO assumes. Thus, CBO expects the net effect on the UI program to be neutral over time.

CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

December 29, 2006

H.R. 2429
Fair Minimum Wage Act of 2005

As introduced in the House of Representatives on May 18, 2005

SUMMARY

H.R. 2429 would amend the Fair Labor Standards Act (FLSA) to increase the federal minimum wage in three steps from $5.15 per hour to $7.25 per hour. The bill also would apply the minimum wage provisions of the FLSA to the Commonwealth of the Northern Mariana Islands (CNMI). The Congressional Budget Office (CBO) estimates that enactment of an identical bill in the next Congress would have no significant effect on the direct spending and revenues of the federal government. Because a very small number of federal employees are paid the federal minimum wage, the bill would have a minor effect on the budgets of federal agencies that are controlled through annual appropriations.

The bill would impose mandates, as defined by the Unfunded Mandates Reform Act (UMRA), on some state and local governments, Indian tribes, and private-sector employers because it would require them to pay higher wages than they are required to pay under current law. The bill also would preempt the minimum wage laws of the CNMI. CBO estimates that the costs to state, local, and tribal governments and to the private sector would exceed the thresholds established by UMRA. (The thresholds in 2007 are $66 million for intergovernmental mandates and $131 million for private-sector mandates, both adjusted annually for inflation.)

For the purposes of this estimate, CBO assumes the legislation will be enacted by March 1, 2007. If so, the minimum wage would rise from $5.15 to $5.85 on May 1, 2007, to $6.55 on May 1, 2008, and to $7.25 on May 1, 2009.

ESTIMATED COST TO THE FEDERAL GOVERNMENT

CBO estimates that enacting H.R. 2429 would have no significant effects on the federal budget.

Affected workers and their families could experience changes to their incomes that would affect the benefits they receive from federal programs such as the Earned Income Tax Credit (EITC), Food Stamps, and Medicaid. However, CBO judges that in aggregate any such impacts would be small, and could result in either higher or lower spending in those programs. Most workers in the affected wage range do not currently participate in those programs. CBO's analysis of the EITC indicates that those workers who are in the earnings range where the EITC is phased out would receive reduced payments that would virtually offset the additional benefits received by those in the phase-in range. Similarly, those Food Stamp participants whose earnings rose would receive fewer benefits, but workers who could not find work at the higher wages or whose hours were cut back would likely claim higher benefits.

The potential revenue effects are similar—small and of indeterminate direction. CBO expects that the workers with increased earnings would have characteristics similar to those whose incomes fall as a result of unemployment or reduced hours. Consequently, the marginal tax rates for the two groups would be comparable, and the changes in the minimum wage would result in little change in aggregate tax revenues.

INTERGOVERNMENTAL AND PRIVATE-SECTOR IMPACT

The amendment would impose both intergovernmental and private-sector mandates, as defined in UMRA, because it would require employers to pay higher wages than they are required to pay under current law. In addition, it would preempt the minimum wage laws of the CNMI. That preemption also is considered a mandate.

To estimate the direct cost to employers of raising the minimum wage (that is, the cost of the new requirement absent any change in their behavior), CBO used information on the number of workers whose wages would be affected in May 2007 and subsequent months, the wage rates these workers would receive in the absence of the bill, and the number of hours for which they would be compensated. The estimate was made in two steps. First, CBO used data from the Current Population Survey to estimate how much it would have cost employers to comply with the mandate had they been required to do so in late 2006. Second, that estimate was used to project the costs to employers beginning in May 2007, taking into account the expected decline over time in the number of workers in the relevant wage range. Those estimates take into account the fact that some states already have, or will have, minimum wages higher than the current federal minimum wage.

CBO estimates that the costs to state, local, and tribal governments would exceed the threshold established by UMRA for intergovernmental mandates ($66 million in 2007, adjusted annually for inflation) in each year beginning in fiscal year 2008. We also estimate that the costs to the private sector would exceed the annual threshold established in the law for private-sector mandates ($131 million in 2007, adjusted annually for inflation) in each year beginning in fiscal year 2007. The following table summarizes the estimated costs of those mandates.

ESTIMATED COSTS OF MANDATES IN H.R. 2429

	By Fiscal Year, in Billions of Dollars				
	2007	2008	2009	2010	2011
COSTS TO STATE, LOCAL, AND TRIBAL GOVERNMENTS					
Increase the federal minimum wage	*	0.1	0.2	0.3	0.3
DIRECT COST TO THE PRIVATE SECTOR					
Increase the federal minimum wage	0.3	1.5	4.0	5.7	5.0
Apply the minimum wage to the CNMI	*	0.1	0.1	0.2	0.2

Note: * = Less than $50 million.

ESTIMATE PREPARED BY:

Federal Costs: Christina Hawley Anthony
Impact on State, Local, and Tribal Governments: Theresa Gullo
Impact on the Private Sector: Ralph Smith

ESTIMATE APPROVED BY:

Robert A. Sunshine
Assistant Director for Budget Analysis

Bruce Vavrichek
Assistant Direct for Health and Human Resources