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Easing the Pain: Let States Opt Out of a Minimum Wage Hike

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The minimum wage does not reduce poverty, and it imposes substantial costs on both the economy and disadvantaged workers.[1] Congress nonetheless appears set to raise the national minimum wage, and the Bush Administration has signaled its willingness to compromise on the issue. But the same wage rate is not appropriate for every state. If a minimum wage increase is going to pass, conservatives should try to make it less harmful, and the best way to do that is to allow states to set their minimum wage rate below the federal level.

An opt-out compromise is more promising than the alternative plan on the table. Previous minimum wage increases have been combined with tax relief for businesses to soften the blow of higher wages. But Democrats promise to implement pay-as-you-go (PAYGO) budgeting in the new Congress, and so tax relief may prove difficult to enact. Additionally, tax sweeteners often include more special interest subsidies than sound pro-growth provisions.

State Economies Differ

Economists and policymakers debate the wisdom of moderate increases in the minimum wage, not massive increases. Both the left and the right recognize that raising the minimum wage to $20 an hour, for example, would cost millions of jobs and hurt the very people it is intended to help. Costs of living and wages vary dramatically between states; therefore, a moderate increase in the federal minimum wage may amount to a massive increase in some states.

A national minimum wage of $7.25 an hour would affect far more jobs in states with lower costs of living. For example, it costs more to live in Massachusetts than in Louisiana, and so jobs in Massachusetts pay more, even though those higher wages may not buy more than the lower wages in Louisiana.

Chart 1 shows the proportion of workers in each state who hold jobs that paid less than $7.25 an hour in 2005.[2] Nationwide, the average hourly wage is $18.05, and 8.1 percent of jobs would be affected by raising the minimum wage to $7.25. For some states this is a trivial increase; for others it is not. In Massachusetts, where average wages are $20.76 an hour, fewer than 5 percent of jobs would be directly affected by the proposed wage hike. In Mississippi, where average wages are less than $15 an hour, more than twice as many jobs—11.5 percent—would be affected by the higher minimum wage.

A one-size-fits-all minimum wage makes no allowance for differences in labor markets among states. Yet the federal government recognizes these differences when it pays its own workers. For example, an entry-level federal job pays 14 percent more in San Francisco than in Huntsville, Alabama.[3] Congress should recognize that private

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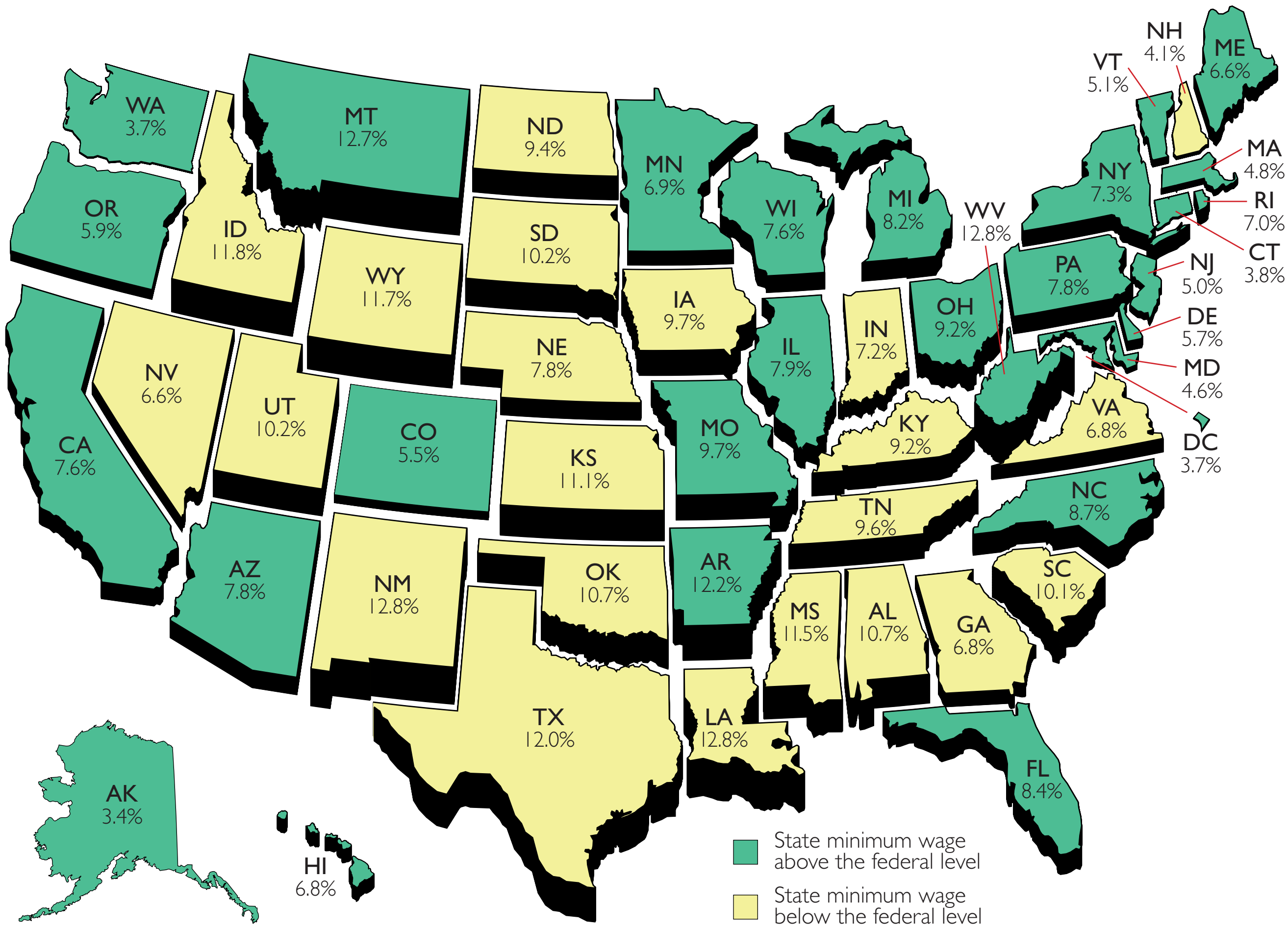
Chart 1 WM 1295

Percentage of Workers Earning Less Than $7.25/hour, by State



Source: Heritage Foundation calculations based on Bureau of Labor statistics, Current Population Survey, Outgoing Rotation Group data for 2005.

businesses face the same cost-of-living differences as the federal government.

An increase that would cost only a few jobs in New York City could leave thousands out of work in Charleston, South Carolina. If Congress is going to raise the minimum wage by 40 percent, it should give heavily affected states the ability to adjust to reflect local economic conditions.

1. James Sherk, "Raising the Minimum Wage Hurts Vulnerable Workers' Job Prospects Without Reducing Poverty," Heritage Foundation *WebMemo* No. 1176, July 25, 2006, at *www.heritage.org/Research/Economy/wm1176.cfm*.
2. The average wage was calculated as the average of usual weekly earnings divided by usual hours worked per week for workers in a state, ignoring individuals who reported earning less than $3 per hour or more than $200 per hour. The proportion of workers in jobs paying less than $7.25 an hour was calculated by taking the proportion of workers paid on an hourly basis whose wages, calculated as above, were less than $7.25 per hour. Data are from the Bureau of Labor Statistics, Current Population Survey, Outgoing Rotation Groups for 2005.
3. Heritage Foundation calculations comparing a GS-1, Step 1 position in the San Jose–San Francisco–Oakland, California, pay area to the same position in the Huntsville-Decatur, Alabama, pay area. Data come from the U.S. Office of Personnel Management, at *http://www.opm.gov/oca/06tables/pdf/saltbl.pdf*.

Regulating Wages Is Already a State Responsibility

States already regulate labor markets in accord with their local economic conditions. Although the federal minimum wage has not increased since 1997, states can raise their own minimum wages above the federal level. Currently 28 states and the District of Columbia, with 67.9 percent of the total U.S. population among them, have minimum wage rates above the federal level.[4]

As Chart 1 shows, the states that have raised their minimum wages above the federal level are those with economies that can most easily adjust to higher rates. Fifteen of the 17 states with wages above the national average have raised their minimum wages; only 13 of the 33 states with wages below the national average have raised theirs.[5]

Legislatures and voters raised minimum wages in states like California and New York where an increase would harm only a small number of workers. States in which a higher minimum wage could cost large numbers of jobs, such as Louisiana and Kansas, have not raised theirs.

Let States Opt Out

If Congress is going to increase the minimum wage by over 40 percent, it should let states set their rates below the federal level. Although most states are unlikely to use this authority, it would allow states with low costs of living to ensure that their minimum wage rates are not wildly out of line with local economic conditions. A one-size-fits-all solution makes no sense when average wages vary widely across the country.

Giving states the ability to keep their minimum wages at levels appropriate to local conditions would also return control to officials who are more in tune with local needs. Because local officials are closer to their constituents, they are also more flexible and able to respond faster than their federal counterparts. Thus, although the federal minimum wage has not been increased for nine years, many states increased their rates without congressional action. Similarly, if a 40 percent increase in the minimum wage costs more jobs than expected in some states, local officials could respond more rapidly to help imperiled workers than Congress.

Conclusion

The minimum wage is a well intentioned but counterproductive way to help low-income workers. Even so, Congress appears ready to raise it. Under these circumstances conservatives should carefully consider policies that could make an increase less painful to workers in states with low costs of living. In the past, minimum wage increases have been coupled with special interest tax breaks, but these do little to make hiring unskilled workers more attractive.

Conservatives should push to allow states to set their minimum wages below the federal level. This policy would restore power to state officials, who are closer and more responsive to voters. It would also ensure that Congress does not impose a massive burden on workers in states with low costs of living, where $7.25 an hour is well above what businesses are able to pay unskilled workers. Allowing states to opt out would protect the workers most at risk of losing their jobs due to a minimum wage increase.

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4. Those states are Alaska, Arizona, Arkansas, California, Colorado, Connecticut, Delaware, Florida, Hawaii, Illinois, Maine, Maryland, Massachusetts, Michigan, Minnesota, Missouri, Montana, New Jersey, New York, North Carolina, Ohio, Oregon, Pennsylvania, Rhode Island, Vermont, Washington, West Virginia, and Wisconsin, and the District of Columbia is also included. Heritage Foundation calculations based on Bureau of Labor Statistics, Current Population Survey, Outgoing Rotation Group data for 2005.

5. *Ibid.*