MINIMUM WAGE
And Its Effect On Kentucky's Economy

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A Bluegrass Institute report

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Executive Summary

While proposals to raise the minimum-wage failed in Washington and Frankfort in 2014, the debate is expected to continue at both the state and federal levels in 2015. A careful review of the evidence reveals no economic consensus that increasing the minimum-wage leads to increased employment. In fact, **mandating a large minimum-wage increase would have a devastating effect on Kentucky's economy and the employment opportunities of its young people:**

- *Larger increases in the minimum-wage cause more job losses than do smaller minimum-wage hikes*. Certainly, Louisville Metro Council's decision to forgo a larger hike in the minimum-wage by raising it to $9 over several years will have a less-harmful effect on employment than a steep immediate increase to $10.10 would.
- *While raising the federal minimum-wage hurts employment generally, it particularly harms it in Kentucky.* Past minimum-wage hikes have resulted in an additional .2 percentage-point increase in Kentucky's unemployment rate relative to the rest of the U.S. The states that see the largest escalation in unemployment from a minimum-wage increase are those with the lowest wages, which is why Kentucky's unemployment rate spikes relative to the U.S. rate when the federal minimum-wage is increased.
- *In May 2013, the mean hourly wage for the country in the food preparation and serving-related occupations group was $10.38 an hour.* Nine percent of U.S. workers were in that occupation compared to 9.4 percent of the Kentucky workforce. Louisville's average wage in this occupational group was $9.70 an hour compared to just $8.79 for the state at large. An increase in the federal minimum-wage would do little for unemployment in the food-service industry nationally, have a minor effect on unemployment in Louisville but a major negative impact on unemployment in the food-service industry in rural Kentucky where wage rates are below state averages.
- *In August 2014, Kentucky's unemployment rate stood at 7.1 percent compared to the national average of 6.1 percent*. A unilateral increase in the Kentucky state minimum-wage – given the commonwealth's relatively high unemployment rate during the past few years and low average-wage rate – would have a significantly negative impact on youth, low-skilled, refugee and rural employment in the commonwealth.
- *The average textile-industry worker in Kentucky currently makes $8.94 an hour.* Increasing labor costs to $10.10 an hour may be enough to ensure the extinction altogether of that industry in Kentucky as the jobs could be outsourced to lower wage countries over time.

Taking the minimum-wage to $10.10 an hour is unprecedented in U.S. history in terms of real purchasing power. Such an increase in Kentucky's minimum-wage will result in lower employment rates for the Bluegrass State's youth and low-skilled workers. Its negative effects will be concentrated in poor, rural counties which already face an uphill battle regarding stubbornly high unemployment rates. Also, fewer jobs for Kentucky's youth will lead to increased reliance on student loans to finance their dreams of higher education.

This is not the time for another 40 percent increase in the Kentucky minimum-wage.

The Minimum Wage And Its Effect On Kentucky's Economy

Introduction

A bill to increase Kentucky's minimum wage to $10.10 an hour passed the Kentucky House of Representatives in early 2014 but failed in the state Senate. Likewise, in April 2014, the U.S. Senate blocked President Obama's request to increase the U.S. minimum wage to $10.10 an hour. The minimum-wage debate is expected to continue at both the state and federal levels throughout 2015. In September, the (Louisville) Courier-Journal reported that a majority of Kentucky voters want the federal government to increase the minimum wage.

Why, then, would some conscientious policymakers want to block popular minimum-wage increases? Are they inherently mean-spirited, or is there a method to their "madness"? A careful review of the theoretical and empirical evidence regarding minimum-wage increases is in order for educated people to make an informed decision regarding increases in the minimum wage.

An analysis of the peer-reviewed minimum-wage research

Contrary to the claims of some politicians, an analysis of the peer-reviewed published work in economics journals reveals ***no*** economic consensus that increasing the minimum wage leads to increased employment. The bulk of empirical evidence shows that small increases in the minimum wage lead to small decreases in employment. Large increases in minimum wages cause more job losses. Joseph Sabia, Richard Burkhauser and Benjamin Hansen (2012, I*ndustrial and Labor Relations Review)* found that by increasing the minimum wage by 40 percent between 2004 and 2007, New York "significantly reduced employment rates of less-skilled, less-educated New Yorkers."

"The only empirical question is how many jobs will be lost. "

A study in 2013 by the nonpartisan Congressional Budget Office found that the most likely outcome of increasing the U.S. minimum wage to $10.10 an hour would be a loss of 500,000 jobs. In truth, their confidence interval was from zero job losses to 1 million job losses. Nowhere in their confidence interval did the CBO suggest that a 40-percent increase in the minimum wage would *create* jobs. The only empirical question is how many jobs will be lost.

The job losses anticipated by economists are not equally distributed throughout the economy. If the minimum wage is increased, neither high-income earners nor skilled workers in high-income states will lose their jobs. Rather, job losses are almost entirely concentrated on those making less per hour than the proposed $10.10 hourly wage. Groups most likely to be put out of work by minimum-wage increases are the very people whom the policy is supposed to help: young people and the working poor.

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A November 2014 study of the 2007 minimum-wage hike, which was came to full fruition in 2009, minimum wage increase by University of California San Diego economists Jeffrey Clemens and Michael Wither noted generally that the minimum-wage increase was responsible for a .7 percentage-point drop in the employment/ population ratio. Upon further studying those workers who were working in states where wages had been below the new higher wage, they found that, "binding minimum wage increases had significant, negative effects on the employment and income growth of targeted workers."

"When minimum-wages increase, labor costs rise in low skilled industries. The result is fewer lower skilled jobs…"

Workers in a market economy are not paid above their marginal-revenue product for extended periods of time. Thus, employers will only hire employees if their wages (plus benefits) are less per hour than the company brings in per hour in new revenue generated by the employees' presence. Employers will not pay someone $10.10 hourly to bring in $8 an hour of new revenue. The person whose skill set combined with the circumstances of time and place allows them to bring in $8 an hour of extra revenue to a firm will be hired if the minimum wage is $7.25 an hour but will lose said job in many businesses if the minimum wage is increased above $8 an hour.

When minimum wages increase, labor costs rise in low-skilled industries. The result is fewer lower-skilled jobs for three reasons:

- Firms that are unable to adapt and generate enough revenue per hour from employees are forced to fire them. This either results in lower output or a complete shutdown of the firm.
- Swelling domestic-labor costs increase the incentive for outsourcing low-skilled manufacturing jobs to lower-wage countries. Capital is mobile and higher-paid workers can be substituted out over time for lower-wage employees.
- Increasing labor costs relative to capital costs encourages employers to replace low-skilled labor more quickly with automation than they would naturally do. Minimum-wage workers can take your fast-food order, but so too can computer kiosks. It wasn't long ago that actual people checked in bags at the airport. Travelers now check their own luggage at kiosks. Jobs that used to be common like gas-station attendants and

> grocery baggers have been pushed out of the labor market by minimum-wage increases. We now mostly pump our own gas and bag our own groceries.

Additionally, higher official minimum wages increase the incentive of unscrupulous employers to hire black market and undocumented workers to work below the official wage. Such workers often are undocumented immigrants who face the real threat of exploitation due to their inability to file employment grievances for fear of exportation. Increased cash-only jobs erode tax revenues for governments as well as eat away at unemployment and Social Security protections of workers.

"There are dramatic reductions in purchasing power for those who actually lose their only job due to the wage hike of others."

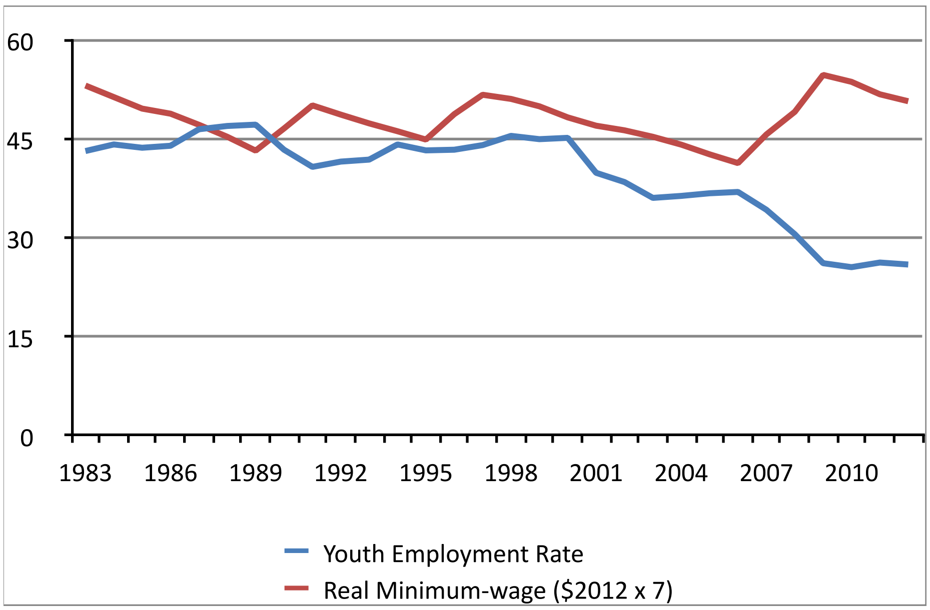
Some workers will indeed benefit from an increase in the minimum wage. Those who keep their jobs will earn more; their increased purchasing power is often noted as an economic benefit. However, the purchasing power for consumers, who then will have to pay higher prices to compensate workers at the increased wage scale, will diminish. When a family faces increased child-care costs, for example, it has to cut back spending elsewhere; it just doesn't spend more money. Furthermore, there are dramatic reductions in purchasing power for those who actually lose their only job due to the wage hike of others.

This is why smaller increases in the minimum wage cause slighter increases in unemployment. If you take the minimum wage from $7.25 to $7.50 an hour, very few employees will lose their job because there are few workers whose marginal revenue product lies exactly between $7.25 an hour and $7.50 per hour. However, a greater number of people will be affected by government mandates requiring higher wages. Those workers who were earning $7.25 an hour but bringing in $12 an hour in extra revenue to their firm won't lose their job when a minimum wage increases to $10.10. Rather, job losses will be concentrated on the least-skilled and least-educated workers in industries with smaller revenue streams. This is why minimum-wage hikes are most costly to teenagers who have the lowest skill and education levels among all age groups of workers.

Where have the teenage jobs gone?

The following chart illustrates the impact of changes in the federal minimum wage on youth (aged 16-19)-employment rates in the U.S. during the last 30 years.

The red line represents the real minimum wage from 1983-2012 (in 2012 dollars times (x) 7 for scale purposes) as provided by the U.S. Department of Labor. The blue line represents the youth-0employment rate as reported by the U.S. Bureau of Labor Statistics.



What the graph illustrates:

- From 1983 until 1990, the purchasing power of the minimum wage was falling while youth employment increased. There is an inflection point in 1990 where the value of the minimum wage spiked and youth employment fell. In March 1990 – the last month before the minimum wage increased to $3.80 – the youth-employment rate stood at 47.1 percent. In April the next year, following an increase in the minimum wage to $4.25, the youth-employment rate stood at 42.8 percent. **In a single year, one out of 10 teenagers with jobs lost them**. The slide continued with the youth-employment rate falling to 40.2 percent by the following March.
- The minimum-wage increases of 1996 and 1997 had a smaller initial impact on youth employment. The youth-employment rate fell from 44.4 percent to 44.1 percent during the month the wage was increased in 1996 compared to a drop from 43.2 percent to 42.8 percent during the month the wage was increased in 1997. The tightening job market of

the late 1990s helped cushion the employment blow of an increased minimum wage. The national unemployment rate was below 5 percent from 1998 until 2001.

- The 2001 recession saw a large decrease in youth employment. This decline stabilized from 2003 through 2007 as the real value of the minimum wage fell. Increased globalization decreased the domestic demand for unskilled labor in the U.S. The 2007, 2008 and 2009 increases in the minimum-wage rate failed to take this lower demand into account. **The huge drop in youth employment that came with the last round of minimum-wage increases has only begun to stabilize since 2009** as the value of the minimum wage has been allowed to fall.
- Between March 1990 and July 2014, the youth-employment rate has fallen from 47.1 percent down to 27.1 percent. That is, 44.8 percent of teenagers who held a job in 1990 no longer hold one in 2014. **Youth employment is almost half of what it was 25 years ago.**

A climb up the income ladder begins by placing one's foot on the lowest bar. More important than the wage young workers earn is the experience, on-the-job training and self-respect gained from being employed.

If society truly wants more people moving up the income ladder, it must stop removing the lowest rungs of that ladder. Even Australia – a country with a high minimum wage – does not apply their full minimum wage to teenagers because they understand the social importance of youth learning to work.

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If there is any doubt concerning what high minimum wages and highly regulated labor markets give young people, look no further than Europe where youth unemployment rates are: Greece (57.7 percent), Spain (54 percent), Croatia (48.7 percent), Italy (43 percent), Cyprus (37.3 percent) and Portugal (34.8 percent). In Europe, 7.5 million young people between the ages of 15 and 24 are not employed, in school or in training. We have seen the future of artificially high minimum wages and it is not pretty.

Is a minimum-wage increase only problematic for teenagers, or will it have further impact on other demographics?

Who makes the minimum-wage or lower?

The U.S. Census Bureau reports that:

- **More than half of minimum-wage workers (50.4 percent) are between 16 and 24 years of age; nearly a quarter (24 percent) are teenagers,** almost two thirds (64 percent) are part time workers, few (15 percent) are breadwinners trying to support a family, and approximately half (45 percent) are in food service preparation/serving related occupations.
- The East South Central census region (Alabama, Kentucky, Mississippi, and Tennessee) is tied with the West South Central region (Texas, Oklahoma, Arkansas, and Louisiana) for the highest percentage (6.3 percent) of minimum-wage workers of any of the nine census regions. The Pacific region, by comparison, only has 1.5 percent of its workforce employed at the minimum-wage. **A federal minimum-wage increase would cause more unemployment in the South Central region than anywhere else.** That is, the 500,000 job losses projected by the CBO would be most heavily concentrated in the southern states, including Kentucky.

To understand the magnitude of job losses, one must consider a $10.10 minimum-wage relative to the history of the minimum-wage in the U.S.

What is the relative purchasing power of the minimum-wage?

The U.S. in 2009 increased the minimum-wage to $7.25. Its purchasing power at that point was higher than it was in 22 of the previous 24 years. The 2013 purchasing power of the minimum-wage was still higher than it was in 22 of the previous 28 years. The round of increases implemented between 2007 and 2009 drove up the minimum-wage by 40 percent. A move to a $10.10 minimum-wage would increase it another 40 percent.

"Rather than supercharging the economy, the last 40 percent increase in the minimum-wage helped to hold it back."

Going from $5.15 to $10.10 an hour is a 96 percent wage increase in seven years – an enormous increase in wages for a country in which median household income fell from $56,436 to $51,939 between 2007 and 2013. (Census Bureau 2013). Rather than supercharging the economy, the last 40-percent increase in the minimum-wage helped to hold it back. Increased wages for some came at the cost of jobs for others and decreased purchasing power for most.

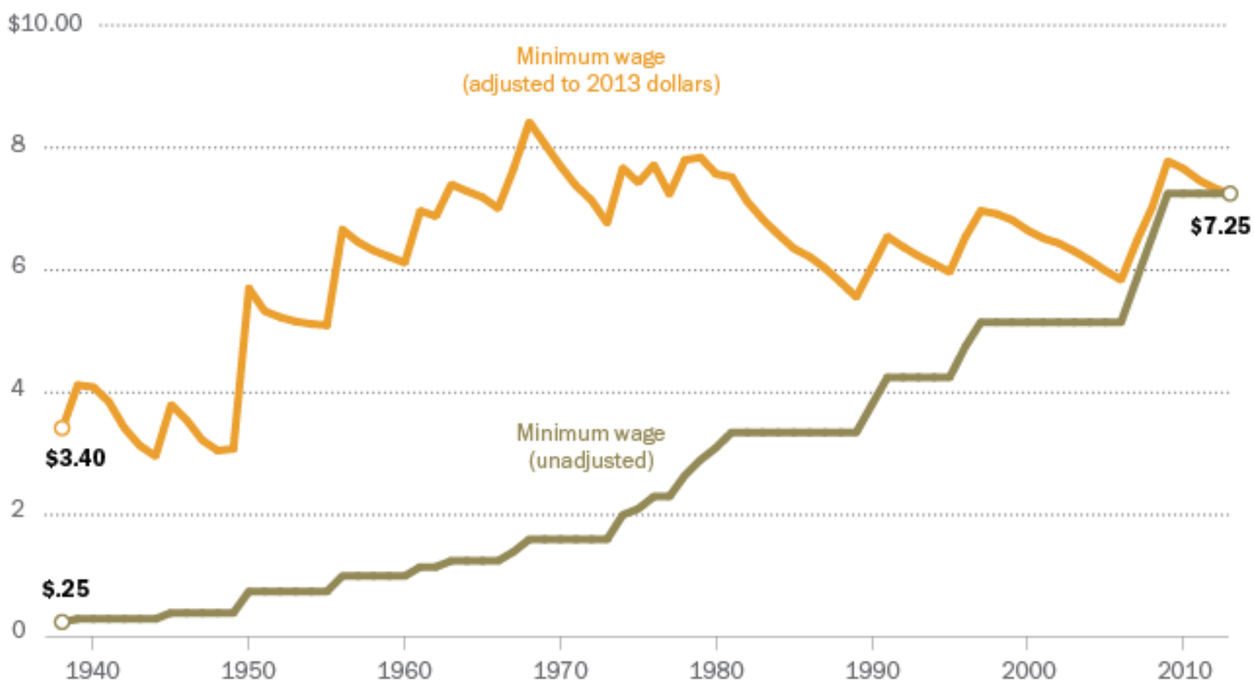
A $10.10 minimum-wage would be the highest minimum-wage – in both nominal and real dollars – that the U.S. has ever put in place. Its employment effects, then, are predicted to be larger and therefore more negative than any other minimum-wage increase in the nation's history.

The situation is only made worse by implementing such a dramatic wage increase while the unemployment rate is still above normal.

"A $10.10 minimum-wage would be the highest minimum-wage – in both nominal and real dollars – that the U.S. has ever put in place."

Federal Minimum Wage, 1938-2013

Shown in nominal (not adjusted for inflation) dollars and 2013 (inflation-adjusted) dollars



Note: Wage rates adjusted for inflation using implicit price deflator for personal consumption expenditures.
Sources: Bureau of Labor Statistics, Bureau of Economic Analysis, Pew Research Center analysis

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How has Kentucky's unemployment rate fared relative to the country's unemployment rate following the last three national increases in the minimum-wage (1990 91, 1996 97, 2007 2009)?

Over the last three rounds of federal minimum-wage hikes, a distinct, predictable and disturbing pattern has emerged regarding Kentucky's unemployment rate. When averaging the differences between Kentucky's unemployment rate and the unemployment rate of the U.S., we find the following relationship:

KY-minus-U.S. Rate Average

One year before the Increase	.3 percent
Year of the Increase	.53 percent
One year after the increase	.51 percent

While raising the federal minimum wage hurts employment generally, it particularly harms it in Kentucky. Past minimum-wage hikes have resulted in opening an additional .2 percentage-point increase in Kentucky's unemployment rate relative to the rest of the U.S.

The states that see the largest escalation in unemployment from a minimum-wage increase are the states with the lowest wages, which is why Kentucky's unemployment rate spikes relative to the U.S. rate when the federal minimum wage is increased.

In May 2013, the mean hourly wage for the country in the food preparation and serving related occupations group was $10.38 an hour. Nine percent of U.S. workers were in that occupation compared to 9.4 percent of the Kentucky workforce. Louisville's average wage in this occupational group was $9.70 an hour compared to just $8.79 for the state at large.

Unemployment Rate in Percentages

Year	U.S.	KY		Year	U.S.	KY
1989	5.3	5.6		2002	5.8	5.6
1990	5.6	6.1		2003	6	6.2
1991	6.7	7.4		2004	5.5	5.3
1992	7.4	6.9		2005	5.1	6
1993	6.8	6.2		2006	4.6	5.7
1994	6.1	5.4		2007	4.6	5.5
1995	5.6	5.4		2008	5.8	6.4
1996	5.4	5.6		2009	9.3	10.7
1997	4.9	5.4		2010	9.6	10.5
1998	4.5	4.6		2011	8.9	9.5
1999	4.2	4.5		2012	8.1	8.2
2000	4	4.1		2013	7.4	7.6
2001	4.7	5.4				

(Source: Bureau of Labor Statistics)

An increase in the federal minimum wage would do little for unemployment in the food-service industry nationally, have a minor impact on unemployment in Louisville, but have a major negative impact on unemployment in the food-service industry in rural Kentucky where wage rates are below state averages.

"A unilateral increase in the Kentucky state minimum-wage rate would have a significantly negative impact on youth, low skilled, refugee and rural employment in the commonwealth."

In August 2014, Kentucky's unemployment rate stood at 7.1 percent compared to the national average of 6.1 percent. Given the Bluegrass State's relatively high unemployment rate and low average-wage rate during the last few years, a unilateral increase in the Kentucky state minimum-wage rate would have a significantly negative impact on youth, low-skilled, refugee and rural employment in the commonwealth.

From August 2013 through August 2014, leisure and hospitality wages increased 3.8 percent in Kentucky, which compares favorably to the 1.3 percent state average. Manufacturing wages only rose .4 percent while construction wages fell .4 percent during the same time. If the long-term trend in leisure/hospitality wages is already positive, the need for government intervention to fight stagnant wages is not needed.

Furthermore, the slow growth rate in manufacturing-sector wages reveals that an increase in the minimum wage to $10.10 an hour could have a devastating impact on low-paying manufacturing jobs in the commonwealth.

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The average textile-industry worker in Kentucky currently makes $8.94 an hour. Increasing labor costs to $10.10 an hour may be enough to ensure the extinction altogether of that industry in Kentucky as the jobs could be outsourced to lower-wage countries over time.

Conclusion

Taking the minimum wage to $10.10 an hour is unprecedented in U.S. history in real purchasing-power terms. Such an increase in Kentucky's minimum wage will result in lower employment rates for the Bluegrass State's youth, refugees and low-skilled workers. Its negative effects will be concentrated in poor, rural counties which already face an uphill battle regarding stubbornly high unemployment rates.

Society cannot take away the lowest rungs on the economic ladder and expect young people, refugees and the unskilled poor to pole vault into the middle class. Fewer jobs for Kentucky's youth will also lead to increased reliance on student loans to finance their dreams of higher education.

This is not the time for another 40-percent increase in Kentucky's minimum wage.

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