

State Minimum Wages and Employment in Small Businesses

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Highlights

This report examines the effects of minimum wages on employment and payrolls in small businesses. The analysis makes several comparisons between *states with a higher minimum wage* than the federal \$5.15 minimum and *all other states* (i.e., those states where the \$5.15 federal minimum prevails). Particular attention is paid in this report to the retail sector since that is the industry employing the most workers at low wages.

The last time the federal minimum wage was increased was in September of 1997. Since then, a growing number of states have raised their own minimum wage levels above the federal \$5.15 level. There are currently 12 states, plus the District of Columbia, that have a higher minimum wage. These 12 higher minimum wage states comprise a diverse set of states and include five northeastern states (Connecticut, Massachusetts, Maine, Vermont, and Rhode Island), the five West Coast states (California, Oregon, Washington, Alaska, and Hawaii), and Delaware and Illinois.

To provide a thorough empirical basis for assessing the effects of minimum wages on employment, particularly for small business, this report makes comparisons between these two groups of states (*higher minimum wage states* and *all other states*) for the period since 1997, in terms of:

- total nonfarm employment,
- total *retail* employment,
- employment and average payroll per worker for all small businesses (defined as those employing less than 50 workers), and
- employment and average payroll per worker for small *retail* businesses.

The overall conclusion of this analysis is that since 1997, employment growth (all nonfarm employment and retail employment) in states with a higher minimum wage than the federal minimum has performed at least as favorably as in states where the \$5.15 federal minimum prevails. That is, state minimum wages higher than the federal minimum wages have not adversely affect employment growth over the past few years. This conclusion holds for both the expansion phase of the economy – the years 1998 through 2000 – as well as the years of recession and extraordinarily slow growth since then (2001 through 2003).

In fact, when considered in the aggregate, taking all states together in two groups, employment outcomes have generally been more favorable in the higher minimum wage states than in all other states. Consider these examples:

- Total employment in the higher minimum wage states increased by 6.2 percent from January 1998 to January 2004, 50 percent greater than the combined job growth of 4.1 percent for the other states where the federal minimum wage prevailed; and
- Retail employment grew by 6.1 percent in the minimum wage states versus 1.9 percent in the other states.

And in looking at the growth in establishments, employment and payrolls for small employers with fewer than 50 employees, a similar picture emerges: small employers in this

diverse set of higher minimum wage states generally fared better than small employers in other states between 1998 and 2001 (1998 and 2001 are the years for which the government's County Business Patterns data make a comparison possible). (Small employers with less than 50 employees accounted for 95 percent of all establishments and 41 percent of total employment.)

The results for small employers included:

- In the under 50 employee size range across all industries, the number of establishments increased by 3.1 percent for the higher minimum wage states compared to a 1.6 percent increase for the balance of the states; and
- Within the retail industry, the number of establishments increased by 0.6 percent for the higher minimum wage states (compared to 0.3 percent for all other states), the number of employees increased by 3.7 percent (versus 2.4 percent), total annual payroll increased by 17.9 percent in the higher minimum wage states and average payroll per worker increased by 13.7 percent (versus, 14.7 percent and 12.0 percent, respectively, for the other states.

We do not know enough from this analysis to conclude that increasing the minimum wage will boost employment growth over what it otherwise would have been. What does seem to be clear, however, is that it is hard to sustain the argument made by some observers that an increase in the minimum wage will result in adverse aggregate employment outcomes.

The analysis of employment and payroll data in this report -- across all states since the last increase in the federal minimum wage -- suggests that it is hard to argue that, in the aggregate, all businesses, or all small businesses, will be adversely affected by higher minimum wages.

Preface

This report examines the effects of minimum wages on small businesses. The Fiscal Policy Institute's James Parrott prepared it, with the assistance of Oliver Cooke. This is the third report in a series prepared by FPI on various aspects of the minimum wage. The **Background** section describes the two earlier reports.

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Fiscal Policy Institute

The Fiscal Policy Institute (FPI) is a nonpartisan research and education organization that focuses on the broad range of tax, budget, and economic and related public policy issues that affect the quality of life and the economic well being of New York State residents. Founded in 1991, FPI's analyses are intended to further the development and implementation of public policies that create a strong, sustainable economy in which prosperity is broadly shared by all New Yorkers. FPI has offices in Albany and New York City. FPI's website is: www.fiscalpolicy.org.

Background

Two reports on the minimum wage have preceded this report. In January 2004, the Fiscal Policy Institute released Raising the Minimum Wage in New York: Helping Working Families and Improving the State's Economy (available at <http://www.fiscalpolicy.org/minmumwagereportrevised20jan2004.pdf>.) A second FPI report was released in March, Immigrant Workers and the Minimum Wage in New York City (available at <http://www.fiscalpolicy.org/ImmigrantWorkers&MinimumWage.pdf>).

The first report helped establish the background on the minimum wage issue and looked at the decline in the purchasing power of the minimum wage. The earlier report noted that wages for low-wage workers in New York are lower than two decades ago and that New York has the greatest disparity among the 50 states between the average wage and the minimum wage. An increase in the minimum wage to \$7.10 an hour would directly benefit an estimated 738,000 workers in New York state now making between \$5.15 and \$7.10 an hour, and likely would boost the wages of many of the nearly 500,000 workers making from \$7.10 to \$8.10 an hour.

Since the retail industry is the lowest paying among major employment sectors of the economy, retail workers comprise 40 percent of minimum wage workers, much greater than their 15 percent share of the overall New York state workforce.

The first report also examined the economics literature dealing with the issue of the relationship between the minimum wage and employment. This review of the economic research literature called into question the traditional textbook model of the labor market that predicted that increases in the minimum wage (the price of low-wage labor) would reduce the demand for low-wage labor and lead to higher unemployment. This conclusion has been reinforced by assessments of the 1996 and 1997 federal minimum wage increases that, using various analytical methods, found that the employment effects were statistically insignificant.

FPI's second report found that immigrant workers in New York City are nearly twice as likely to earn minimum wages as native-born workers and comprise 62 percent of the New York City workers who would be directly affected by an increase in the New York state minimum wage. Contrary to claims that the minimum wage mainly affects teenagers, 90 percent of minimum wage workers in New York City are adults and two-thirds work full-time. Sixty percent of increased minimum wage earnings would go to lowest-earning 40 percent of New York City households. The earnings of minimum wage workers represent the *sole source of earnings* for half of all families with a minimum wage worker.

Introduction

The question often arises when increases in the minimum wage are considered about the effect on small businesses. Some observers contend that small businesses that are labor intensive and that largely employ low-wage workers will experience sharp cost increases with the result that they will be forced to reduce their employment levels. This claim is consistent with the traditional, simplistic textbook supply and demand theoretical model that holds that an increase in the price of low-wage labor will reduce the demand for labor, i.e., the number of jobs or hours worked.

However, there is now a growing consensus among economists that the traditional theoretical textbook model is incomplete and does not accurately reflect the workings of the low-wage labor market.¹ More sophisticated models of how the economy operates suggest that employers are likely to respond to a wage increase by improving the skills of their workers and becoming more efficient, and that slightly higher wages would be offset by savings from reduced turnover and higher productivity. Recent historical evidence supports this richer understanding of how labor markets operate. The most revealing commentary on the current state of research regarding the minimum wage is presented in the 1999 Economic Report of the President. This report, which is submitted to Congress annually together with the report of the President's Council of Economic Advisers, stated:

Many studies have examined this issue [the dis-employment thesis], and the weight of the evidence suggests that modest increases in the minimum wage have had very little or no effect on employment. In fact, a recent study of the 1996 and 1997 increases, using several different methods, found that the employment effects were statistically insignificant.²

The federal minimum wage was last raised in September of 1997 when it was increased from \$4.75 to \$5.15 an hour. New York State last raised its minimum wage in 2000, but that action only brought it up to the federal \$5.15 an hour level.³ At the time of the last federal increase in 1997, only four states (Alaska, Hawaii, Massachusetts, and Oregon) and the District of Columbia had minimum wages above the federal \$5.15 level. Since that time, 8 other states (California, Connecticut, Delaware, Illinois, Maine, Rhode Island, Vermont, and Washington) have also raised their state minimum wages. At a municipal level, San Francisco, Santa Fe, Santa Monica, and Madison, Wisconsin have all recently established citywide minimum wages.

¹ For a discussion of the economic research literature on this issue, see the Appendix in Raising the Minimum Wage in New York: Helping Working Families and Improving the State's Economy, January 2004, Fiscal Policy Institute. This report is available at: <http://www.fiscalpolicy.org/minmumwagereportrevised20jan2004.pdf>.)

² Economic Report of the President, 1999, p. 112.

³ On two occasions in recent decades, New York has raised its minimum wage above the federal level, once in 1967 and again from 1970 to 1974.

With several states having minimum wage levels above the federal level prevailing in the balance of the states in recent years, it is now possible to examine employment trends between the state minimum wage states and the federal minimum wage states. This report makes several such comparisons in order to provide more of an empirical basis for assessing the effects of minimum wages on employment, particularly for small businesses. Thus, this report provides comparisons between these two groups of states in terms of:

- total nonfarm employment,
- total *retail* employment,
- employment and average payroll per worker for all small businesses (defined as those employing less than 50 workers), and
- employment and average payroll per worker for small *retail* businesses.

State Minimum Wages

Table 1 on the next page shows federal and state minimum wage changes since 1996. Twelve states and the District of Columbia now have minimum wages above the \$5.15 federal level. For purposes of the comparisons of total nonfarm employment and total retail employment Illinois is excluded from the group of states with higher state minimums since its minimum wage was only increased above the federal level on January 1, 2004. Thus, for the comparisons of total nonfarm employment and total retail employment, 11 states plus the District of Columbia are considered the "State minimum wage states".

The analysis of employment and payroll trends for small businesses (defined here as establishments with fewer than 50 employees) compares data for 1998 and 2001. The source for the small business analysis is the U.S. Commerce Department's *County Business Patterns* (CBP) series; 2001 is the latest year the CBP data are available). Since Maine first increased its minimum wage above the federal level in 2002, both Maine and Illinois are excluded from the group of minimum wage states for purposes of the small business analysis. Thus, for this analysis, 10 states plus the District of Columbia are considered the "State minimum wage states".

As states began increasing their state minimum wages since the last federal increase in 1997, the number of states with higher minimum wages increased from five (plus D.C.) in 1998 to 10 in 1999. And since many of these states continued to increase their state minimums, the average wage in the states with higher minimums has increased each year since 1998. For the 11 states (plus D.C.) with higher minimums than the federal government between 1998 and 2003, the average minimum wage increased from \$5.33 in 1998 to \$6.56 in 2003. (See Table 2) When Maine is excluded from this average since its increase took effect only in 2002, the average for the minimum wage states is slightly higher.

Table1: Federal and State Minimum Wage Changes Since 1996										
(Month and date of increase listed below the new minimum wage amount)										
	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
U.S.	\$4.75 10/1	\$5.15 9/1								
AK	\$5.25 10/1	\$5.65 9/1						\$7.15 1/1		
CA		\$5.00 3/1	\$5.75 3/1			\$6.25 1/1	\$6.75 1/1			
CT				\$5.65 1/1	\$6.15 1/1	\$6.40 1/1	\$6.70 1/1	\$6.90 1/1	\$7.10 1/1	
DE		\$5.00 1/1		\$5.65 5/1	\$6.15 10/1					
D.C.	\$5.25	\$5.25		\$6.15						
HI *	\$5.25						\$5.75 1/1	\$6.25 1/1		
IL									\$5.50 1/1	\$6.50 1/1
ME							\$5.75 1/1	\$6.25 1/1		
MA		\$5.25 1/1			\$6.00 1/1	\$6.75 1/1				
OR **	\$4.75	\$5.50 1/1	\$6.00 1/1	\$6.50 1/1				\$6.90 1/1	\$7.05 1/1	
RI				\$5.65 7/1	\$6.15 9/1					
VT		\$5.00 1/1		\$5.75 10/1		\$6.25 1/1			\$6.75 1/1	\$7.00 1/1
WA ***				\$5.70 1/1	\$6.50 1/1	\$6.72 1/1	\$6.90 1/1	\$7.01 1/1	\$7.16 1/1	

* Hawaii raised its minimum wage to \$4.75 4/1/92 and to \$5.25 1/1/93.

** Oregon raised its minimum wage to \$4.75 1/1/91. Beginning Jan. 1, 2004, and annually thereafter, Oregon's minimum wage will be adjusted by a calculation using the U.S. City Average CPI for All Urban Consumers for All Items (rounded to the nearest five cents).

*** Beginning Jan. 1, 2001, and annually thereafter, Washington's minimum wage is adjusted by a calculation using the prior year's CPI for urban wage earners and clerical workers.

Table 2: Average minimum wage and amount by which average minimum wage exceeds \$5.15 federal minimum, for states with higher minimums, 1998-2004

	1998	1999	2000	2001	2002	2003	2004
11 states plus D.C.*							
average minimum	\$5.33	\$5.53	\$5.87	\$6.11	\$6.29	\$6.56	\$6.64
exceeds federal \$5.15	\$0.18	\$0.38	\$0.72	\$0.96	\$1.14	\$1.41	\$1.49
10 states plus D.C.**							
average minimum	\$5.35	\$5.56	\$5.94	\$6.20	\$6.34	\$6.58	\$6.67
exceeds federal \$5.15	\$0.20	\$0.41	\$0.79	\$1.05	\$1.19	\$1.43	\$1.52

Averages are simple averages, not weighted by employment.

* 11 states include: Alaska, California, Connecticut, Delaware, Hawaii, Maine, Massachusetts, Oregon, Rhode Island, Vermont, and Washington.

** 10 states are the ones above minus Maine, which increased its minimum in 2002.

Note: Illinois is excluded since its minimum did not rise until 2004.

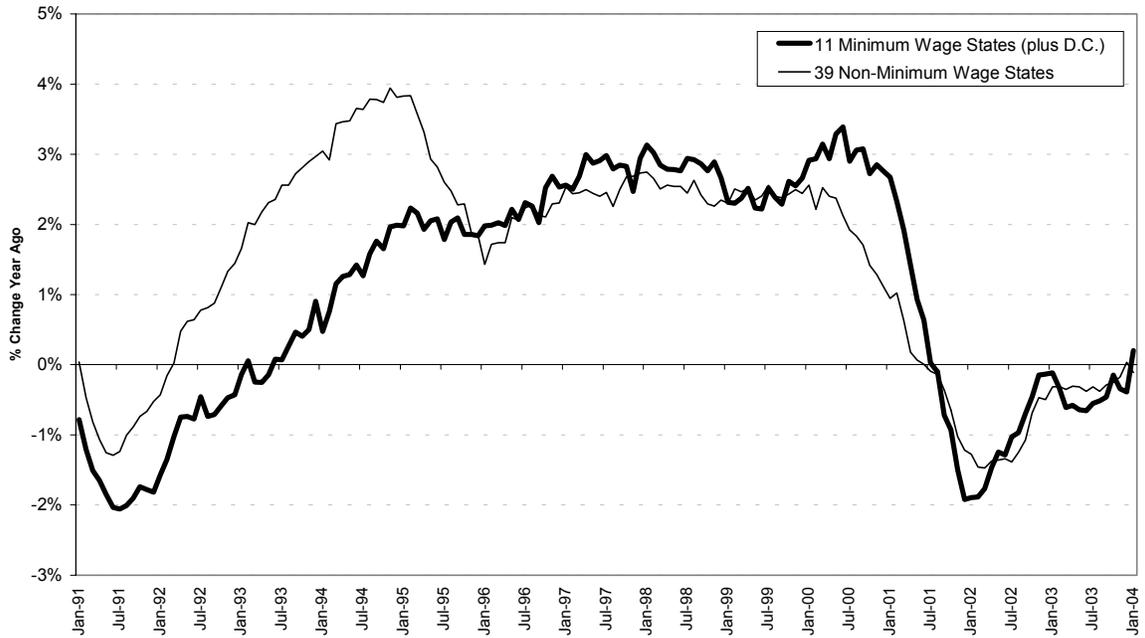
Comparisons between Minimum Wage States and Other States based on Total Employment

Total nonfarm employment in a state can be affected by many factors, particularly the condition of the national economy overall (whether the economy is expanding or contracting), and by the forces affecting the largest and most prominent industries in each state. It is also clear from an examination of total employment trends over the years since the last increase in the federal minimum wage, that state minimum wages do not appear to have an adverse effect on total employment. Figure 1 on the next page shows the year-over-year change in total employment for the 11 states (plus the District of Columbia) with higher minimum wages at some point between the last federal increase in 1997 and 2003, compared to the total employment for the other 39 states (the states where the \$5.15 an hour minimum wage prevails). This figure shows that while total employment growth in the minimum wage states lagged the other states coming out of the early 1990s recession, from the time of the last federal increase in September 1997 through the end of the national expansion (early 2001), employment growth in the minimum wage states generally exceeded that of all other states combined. And since the onset of the national recession in March 2001, and the period of exceptionally weak national job growth from the "official" end of the national recession in November 2001 through January 2004, job growth in the minimum wage states has generally tracked that of the balance of states.

From the entire period from January 1998 to January 2004, aggregate employment in the minimum wage states (plus D.C.) increased by 6.15 percent. This is 50 percent greater than the combined job growth of 4.11% for the other 39 states.

State Minimum Wages and Employment in Small Businesses

Figure 1: Total Nonfarm Employment Growth for 11 Minimum Wage States (plus D.C.) compared to 39 Non-Minimum Wage States, Jan. 1991-2004



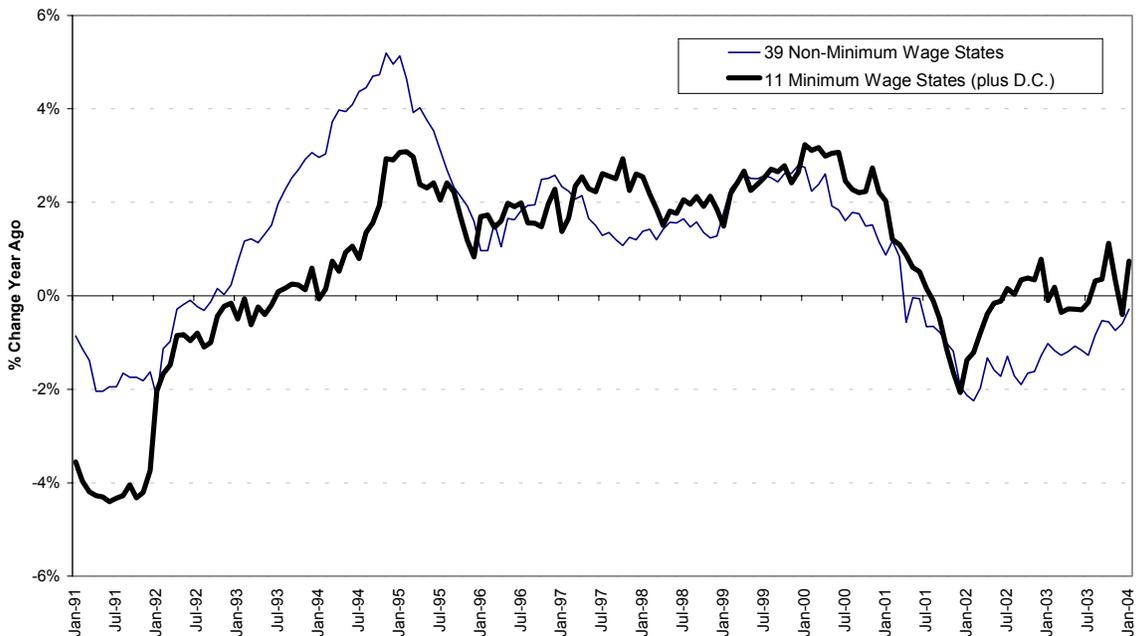
Source: U.S. Bureau of Labor Statistics.

Comparisons between Minimum Wage States and Other States based on Retail Trade Employment

Retail trade jobs tend to pay the lowest wages among all industries in the economy, and thus, are more likely to be affected by the minimum wage than other industries. This section makes the same comparisons as the previous section, except that employment growth is considered just for the retail trade industry. Figure 2 shows the year-over-year change in retail employment for the 11 states (plus the District of Columbia) with higher minimum wages, compared to the total employment for the other 39 states. The results are basically similar as those in Figure 1: the minimum wage states had weaker retail job growth in the early and mid-1990s, then job growth that surpassed other states during the period from 1998 through early 2001. However, while retail job growth fell sharply for the minimum wage states during the 2001 recession, since then retail job growth for these states has consistently surpassed growth in the other states.

Over the entire January 1998 to January 2004 period, retail employment grew by 6.11 percent in the 11 minimum wage states (plus D.C.), more than three times as great as the 1.89 percent retail job growth in the other 39 states.

Figure 2: Since 1999, when several states raised their minimum wages above the \$5.15 federal level, retail job growth in these states has out-performed retail job growth in all other states



Source: U.S. Bureau of Labor Statistics.

Comparisons for Small Businesses between Minimum Wage States and Other States

As mentioned in the Introduction, concern for the effect on small businesses often arises when minimum wage increases are proposed. Most businesses are relatively small employers and in total, these small employers account for a large share of total employment. This report uses an employment threshold of 50 to define “small businesses”. The most comprehensive official government data source for employment and payroll information by employment size of business is the U.S. Commerce Department’s *County Business Patterns* (CBP) series. The latest year the CBP data are available for is 2001. The CBP series made a switch to the new North American Industry Classification System (NAICS) from the Standard Industrial Classification (SIC) system with the publication of the 1998 data. Because of this, our analysis compares the years 1998 and 2001.

In 1998, establishments across all industries with fewer than 50 employees accounted for 94.8 percent of all establishments and 41.5 percent of all employment. The average payroll⁴ per worker for small establishments was \$26,939. This amount was 88 percent of the \$30,609 average per worker payroll across all establishments.

We compared the change in the number of establishments, employment, total payroll and average payroll between the 10 minimum wage states⁵ (plus D.C.) and the 40 other states. Table 3 summarizes these comparisons. Each of these measures grew faster for the minimum wage states paying minimums above the \$5.15 an hour federal minimum than for the 40 states where the \$5.15 federal minimum wage prevailed. The number of small employer establishments grew by 3.1 percent in the minimum wage states, nearly twice the 1.6 percent rate for the other 40 states. The number of employees in small establishments grew by 4.8 percent between 1998 and 2001, nearly 50 percent faster than the 3.3 percent growth pace in the other states. Total annual payroll and average payroll also grew slightly faster in the 10 minimum wage states than in the other states.

These results were also generally more favorable for the minimum wage states than for the state of New York. The sole exception was average payroll per worker that increased by 13.3 percent in New York between 1998 and 2001, versus 13.0 percent for the minimum wage states. (In New York, the number of establishments increased by 2.2 percent, the number of employees in small employers increased by 3.8 percent, and total payroll for these employers increased by 17.6 percent.)

⁴ Payroll includes all forms of compensation, such as salaries, wages, reported tips, commissions, bonuses, vacation allowance, sick-leave pay, employee contributions to qualified pension plans, and the value of taxable fringe benefits.

⁵ Whereas 11 minimum wage states were used earlier, for this analysis, ten minimum wage states were used since the time period under consideration ends with 2001 and Maine did not increase its minimum wage above the federal level until 2002.

**Table 3: Growth Among Small Businesses, 1998 to 2001,
Comparisons between 10 Minimum Wage States (plus D.C.)
and the other 40 States with federal \$5.15 Minimum Wage**

All establishments with less than 50 employees
Percent change from 1998 to 2001

	10 Minimum Wage States* (plus D.C.)	40 States with \$5.15 Federal Minimum Wage
Numer of establishments	3.1%	1.6%
Number of employees	4.8%	3.3%
Annual payroll	18.5%	15.4%
Average payroll per worker	13.0%	11.7%

* States with higher than federal minimum wage include: AK, CA, CT, DE, HI, MA, OR, RI, VT, and WA.

Source: U.S. Commerce Department, County Business Patterns.

Comparisons for Small Retail Trade Businesses between Minimum Wage States and Other States

Table 4 provides a similar comparison between the 10 minimum wage states and the other 40 states but looking specifically at small *retail* employers. Again, the results are consistently more favorable for the 10 minimum wage states over the 1998 to 2001 period. The number of small establishments increases at twice the pace as for the other 40 states, and the number of employees working for small employers increases by 3.7 percent compared to 2.4 percent for small retail employers in the other states.

In New York, one of the other states, the results generally are more favorable than for the 10 minimum wage states in the aggregate as well as more favorable than for the 40 other states overall. The number of small retail establishments increased by 0.9 percent versus 0.6 percent for the minimum wage states, total payroll increased slightly faster and average payroll increased by 14.5 percent compared to 13.7 percent for the minimum wage states. Only in the area of employment, did the minimum wage states record faster growth than New York: 3.7 percent compared to 3.1 percent growth from 1998 to 2001.

**Table 4: Growth Among Small Retail Businesses, 1998 to 2001,
Comparisons between 10 Minimum Wage States (plus D.C.)
and the other 40 States with federal \$5.15 Minimum Wage**

All retail establishments with less than 50 employees
Percent change from 1998 to 2001

	10 Minimum Wage States* (plus D.C.)	40 States with \$5.15 Federal Minimum Wage
Numer of establishments	0.6%	0.3%
Number of employees	3.7%	2.4%
Annual payroll	17.9%	14.7%
Average payroll per worker	13.7%	12.0%

* States with higher than federal minimum wage include: AK, CA, CT, DE, HI, MA, OR, RI, VT, and WA.

Source: U.S. Commerce Department, County Business Patterns.

Conclusions

A growing body of both empirical and theoretical work has called into question the long-held prediction that a higher minimum wage will reduce the number of jobs. A more nuanced model of how the economy operates has superseded the simplistic supply and demand theoretical model that is the basis for this prediction. This more sophisticated labor market model suggests that employers are likely to respond to a wage increase by improving the skills of their workers and becoming more efficient, and that slightly higher wages would be offset by savings from reduced turnover and higher productivity. Recent empirical evidence supports this new theoretical understanding. As the 1999 Economic Report of the President indicated, studies of the 1996 and 1997 federal minimum wage increases found that there were no adverse employment effects.

In the seven years since the federal minimum wage was last increased, several states have enacted and maintained state minimum wage levels above the federal \$5.15 hourly minimum. It is now possible to make job growth comparisons over several years between a set of 10 or 11 states (with the exact number depending on the years studied) with higher minimum wages versus the remaining states where the \$5.15 federal minimum wage prevails. This report makes such comparisons, for employment in all industries together and for the retail trade industry, the industry most often paying low wages and most likely to be affected by the minimum wage. The results clearly point toward no adverse employment effects in the minimum wage states between January 1998 and January 2004. In fact, the findings show that job growth in the higher minimum wage states surpassed that in the remaining states.

It is sometimes suggested that small businesses are the most vulnerable to minimum wage increases. Some observers contend that small businesses that are labor intensive and that largely employ low-wage workers will experience sharp cost increases, leading them to reduce employment levels. This report also examined the trends in employment and total payroll for small businesses employing fewer than 50 workers in the higher minimum wage states compared to the remaining states. For the 1998 to 2001 period for which analysis is possible using the latest Commerce Department data, employment and payroll growth in the higher minimum wage states performed better than in the remaining states.

These results should not be interpreted as showing that raising the minimum wage will boost job growth overall, in the retail trade industry, or among small businesses or small retailers in particular. Rather, this analysis should further call into question notions that an increase in the minimum wage will hurt small businesses overall or employment in small businesses in the aggregate.