BALLOT PROPOSITION #202
Arizona Minimum Wage Act

FISCAL ANALYSIS

Description

Proposition 202 would increase the state's minimum wage to $6.75. This rate would take effect on January 1, 2007 and would increase in each subsequent year by the cost of living, as measured by the consumer price index (CPI). The State of Arizona and small businesses (defined as entities that have less than $500,000 in gross annual revenue) are exempt from this measure. Arizona currently uses the federal rate of $5.15 as the state's minimum wage rate. Employers who violate recordkeeping, posting, or other requirements shall be fined at least $250 for the first violation, and at least $1,000 for each subsequent violation. Additionally, they may be subject to special monitoring and inspections. The state Industrial Commission is authorized to enforce the provisions of Proposition 202.

Estimated Impact

The State may receive additional revenues in the form of civil penalties from violators of the provisions of Proposition 202. The state Industrial Commission will have responsibility to enforce these provisions. The civil penalties may be retained by the agency that recovered them and used to finance enforcement of the proposition. The total amount of civil penalties will depend on the level of compliance, which is difficult to predict in advance.

An increase in wages may also have an economic impact on state and local revenue collections and state spending. By increasing wages and business costs, the proposition may affect individual income tax, corporate income tax and sale tax collections. In addition, a minimum wage increase may affect participation in, and the cost of, public assistance programs. It is difficult to predict the impacts of the proposition on either state revenues or spending in advance.

The state Industrial Commission does not have an estimate of its cost of enforcing the proposition.

Analysis

Federal law requires that all employees covered under the Fair Labor Standards Act are paid at least $5.15 per hour. The law applies to most individuals with a few exceptions, such as for certain administrative, professional, and sales employees. Since Arizona does not currently have a state minimum wage, the state adopts the federal rate of $5.15. Proposition 202 increases the state's minimum wage to $6.75 in 2007 and then indexes it to inflation in each subsequent year. The potential economic and fiscal impacts of this initiative are described below.

<u>Impact on Businesses</u>
An increase of the minimum wage may result in higher labor costs for businesses in Arizona. To compensate for the higher wage costs, businesses may attempt to raise product prices, reduce other labor costs (e.g., non-wage benefits), and/or substitute capital for labor through automation. If they are unable to pass on the higher labor costs to consumers or raise their productivity, business may experience reduced profits and possibly reduced operations in the state. This could result in a decline in both employment and business activity.

<u>Impact on Wage Earners</u>
In the absence of any negative employment (or "disemployment") effects, the initiative would directly benefit all employees in the state that are currently earning between $5.15 and $6.75 per hour. According to a report titled *Characteristics of Minimum Wage Workers: 2004*, which was released by the Bureau of Labor Statistics (BLS) in April 2005, Arizona had an estimated 43,000 employed wage and salary workers paid hourly rates with earnings at or below the federal minimum wage of $5.15 in 2004. This data was derived from the Current Population Survey (CPS), a nationwide sample survey of households that includes questions enabling the identification of hourly-paid workers and their hourly wage rate. However, BLS also noted that since the estimate above excluded salaried and other non-hourly workers, it likely understated the actual number of workers at or below the minimum wage in Arizona in 2004. BLS also reported that minimum wage earners tend to be young (25% are between age 16 and 19, and 26% are between age 20 and 24), female (66% are women), and employed part-time (62% are part-time employees). The Arizona Department of Economic Security does not have data on the number

of workers in the state with hourly earnings between $5.15 and $6.75. The proponents of the proposition claim that more than 145,000 employees in the state will benefit from the proposed minimum wage increase.
Empirical work has shown that an increase in the minimum wage may also benefit those employees that earn more than the new minimum wage, as documented in a 1983 article published in *The Journal of Human Resources* ("The Impact of the Minimum Wage on Other Wages"). This "ripple effect" of the minimum wage tends to be largest for those workers that are closest to the new minimum wage rate. Such wage increases may be instituted to preserve the existing wage structure within a company.

The responsiveness of labor demand to a change in wage rates is measured as an "elasticity." Generally, the greater the wage elasticity of labor demand, the greater the disemployment effect. However, labor economists' estimates of the wage elasticity vary widely, as documented in the September 1998 issue of the *Journal of Economic Literature* ("Economists' Views about Parameters, Values, and Policies: Survey Results in Labor and Public Economics"). For example, the survey response of labor economists from 40 leading research universities indicated that an increase of the minimum wage of 10% would be associated with a 0% to 3% decrease in teenage employment, with a 1% decrease representing the median estimate.

<u>Impact on Consumers</u>
Consumers may also be affected by the proposed minimum wage increase insofar as businesses may increase their product prices in response to the associated cost increase. In other words, some businesses may be able to partially or fully pass along the wage increase to their customers. However, as noted above, other businesses may absorb the higher labor cost stemming from the minimum wage increase without raising prices.

<u>Impact on State Revenues</u>
The economic impact of a state minimum wage on individuals and businesses may also affect state revenues, particularly with respect to income and sales taxes, as outlined below.

Individual Income Tax
Those employees with a higher wage may also pay a somewhat higher state individual income tax than under current law. However, some of these revenue gains may be offset if there is any negative employment effect associated with the minimum wage increase. In addition, any reduced profits may result in a reduction of individual income taxes for those businesses that are operating as Subchapter S corporations, limited liability companies, partnerships, or sole proprietors.

Proposition 202 may also affect the number of taxpayers that claim certain income tax credits provided in statutes. These tax credits – credit for increase sales taxes paid (A.R.S. § 43-1072.01) and family income tax credit (A.R.S. § 43-1073) – are both subject to certain income requirements.

Corporate Income Tax
The higher wage costs associated with a minimum wage increase may result in reduced corporate profits, which in turn may reduce state corporate income tax payments. The tax revenue impact depends on the extent to which corporations would be able to offset the cost increase.

Sales Tax
Those individuals that would benefit from the proposed state minimum wage may have a higher disposable income, which in turn may result in increased spending and thus higher sales tax revenues for the state. The opposite scenario would occur for those individuals that may lose their jobs as a result of this proposal. Sales tax revenues could also increase as a result of businesses raising their product prices in response to the minimum wage increase, as long as such price increases would not be offset by a reduction in quantities of goods sold.

The aforementioned *Journal of Economic Literature* article suggests that economists generally expect a minimum wage increase to result in some reduction in teenage employment. However, a frequently quoted study by two economists, David Card and Alan B. Krueger, which was published in the *American Economic Review* in September 1994 ("Minimum Wages and Employment: A Case Study on the Fast Food Industry in New Jersey and Pennsylvania") found no evidence of reduced employment from an increase in the New Jersey state minimum wage in April 1992.

The academic minimum wage studies do not generally attempt to quantify the overall state revenue impact of a minimum wage increase. As noted above, a higher minimum wage could theoretically affect state revenue collections, especially individual income and corporate income taxes and sales taxes, in opposite directions. As a result, it is difficult to predict the impact on state revenue collections in advance.

Impact on State Expenditures
The wage increase could result in state savings if there is a reduction in the number of citizens who rely on public assistance. A higher minimum wage could potentially affect participation in a number of Arizona Health Care Cost Containment System (AHCCCS), Department of Economic Security (DES), and Department of Health Services (DHS) programs, in which eligibility is determined by income level. It is difficult to determine the impact of a higher minimum wage on participation in advance.

The proposition exempts state government, as an employer, from paying the higher minimum wage. JLBC Staff currently lacks information as to whether the state employs contractors which pay employees less than $6.75 an hour. If the contractor's wages were below $6.75 an hour, state contracted costs could increase as contractors raise wages.

The Industrial Commission of Arizona (ICA) will have enforcement responsibilities for the new minimum wage. Currently, the ICA does not have a role in enforcing the federal minimum wage rate. The proposition authorizes the ICA to order employers in violation of the new minimum wage to compensate employees for any unpaid wages or other amounts. The ICA may also assess a civil penalty against any employer in violation of the proposition. Revenues received from these civil penalties may be used to enforce the proposition. The total amount of civil penalties will depend on the level of compliance, which is difficult to predict in advance.

Local Government Impact

The Urban Revenue Sharing formula distributes 15% of income taxes collected 2 years prior to incorporated cities and towns. Depending on how the wage increase impacts income tax revenues, these distributions could change starting in FY 2009. The proposition also requires political subdivisions to pay the increased wage rate. Those subdivisions may incur increased contractor costs due to the increase. Additionally, cities and towns may also experience increased labor costs due to the ripple effects of the wage increase.

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