BALLOT PROPOSITION 206

FISCAL ANALYSIS

Estimated Impact

A.R.S. § 19-123D requires the JLBC Staff to prepare a summary of 300 words or less on the fiscal impact of voter-initiated ballot measures. Proposition 206 would increase the state's current hourly minimum wage of $8.05 in 4 steps to $12.00 in 2020. The rate would thereafter increase in each subsequent year by the cost of living. Under current law, the state's minimum wage also increases annually by the cost of living. Beginning July 1, 2017, Proposition 206 also requires employers to provide employees a minimum of 1 hour of paid sick leave per 30 hours worked. Under Proposition 206, the State of Arizona and certain small businesses would continue to be exempt from paying the minimum wage. The State of Arizona would also be exempt from paid sick leave provisions of the measure.

Proposition 206's provisions may have an economic impact on state and local revenue collections and state spending. By increasing wages and business costs, Proposition 206 may affect individual income tax, corporate income tax and sales tax collections. In addition, Proposition 206's provisions may affect participation in, and the cost of, public assistance programs. It is difficult to determine the impacts of Proposition 206 on either state revenues or spending in advance.

The state may currently levy civil penalties against violators of the minimum wage laws. Proposition 206 expands these penalties to violators of the paid sick leave requirements. These additional penalties would be retained by the state Industrial Commission to finance enforcement of Proposition 206.

The state Industrial Commission may incur costs to implement a public education program under Proposition 206 to inform individuals about paid sick leave requirements.

Background

Arizona law requires employers to pay a minimum wage of $8.05 an hour in 2016 instead of the federal minimum wage of $7.25 an hour. The state rate is adjusted annually for changes in the federal consumer price index (CPI). Proposition 206 would increase the state's minimum wage of $8.05 in 2016 to $10.00 in 2017, $10.50 in 2018, $11.00 in 2019 and $12.00 in 2020 and index the rate to the federal CPI in later years.

State and federal law do not mandate a minimum amount of paid sick leave for workers. Beginning July 1, 2017, Proposition 206 would require employers to provide employees a minimum of 1 hour of paid sick leave per 30 hours worked. Employees of establishments with less than 15 workers would be entitled to use a minimum of 24 hours of sick leave yearly while employees of establishments with 15 or more workers would be entitled to use a minimum of 40 hours of sick leave yearly.

The state Industrial Commission currently enforces the state's minimum wage requirements. Proposition 206 expands the agency's authority to include enforcement of the measure's paid sick leave requirements. Employers that violate recordkeeping, posting, and other requirements of minimum wage provisions are currently fined at least $250 for the first violation and at least $1,000 for each subsequent violation. Under Proposition 206, these same penalties would apply to violations of the sick leave requirements. The state Industrial Commission is already permitted to retain these fines for enforcement purposes.

Proposition 206 would also allow the state Industrial Commission to implement a public education program to inform individuals about paid sick leave requirements available under the measure.

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Analysis

Minimum Wage Provisions

Based on projected inflation estimates from a leading national forecasting company, the state's current law minimum wage of $8.05 in 2016 is forecast to increase to $8.80 by 2020. *Table 1* shows that the minimum wage under Proposition 206 would exceed the amounts projected under current law by $1.85 in 2017 and by $3.20 once the measure's phase-in period is complete in 2020.

Table 1

Minimum Wage Under Current Law and Proposition 206

		Hourly Minimum Wage			
CY	Projected Inflation	Current Law 1/	Prop. 206	$ Difference	% Difference
2016		$ 8.05	$ 8.05	$ -	0.0%
2017	1.12%	$ 8.15	$ 10.00	$ 1.85	22.7%
2018	2.71%	$ 8.35	$ 10.50	$ 2.15	25.7%
2019	2.26%	$ 8.55	$ 11.00	$ 2.45	28.7%
2020	2.68%	$ 8.80	$ 12.00	$ 3.20	36.4%

1/ Pursuant to A.R.S. § 23-363, once the minimum wage is adjusted for annual inflation, it is rounded to the nearest multiple of $0.05.

The potential economic and fiscal impacts of Proposition 206's minimum wage provisions are described below.

Impact on Businesses

An increase of the hourly 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, businesses may experience reduced profits and possibly reduced operations in the state. This could result in a decline in both employment and business activity.

Impact on Wage Earners

In the absence of negative employment (or "disemployment") effects, Proposition 206 would directly benefit employees that earn less than the measure's $12.00 phased-in hourly minimum wage. Using Occupational Employment Statistics data from surveys of Arizona businesses, the Arizona Department of Administration (ADOA) estimates that 706,845 workers earned a wage of $12.00 or less during 2015. *Table 2* provides additional detail of estimated employment by wage groups.

Table 2

Arizona Employment by Wage Group in 2015

Hourly Wages			Number of Employees
$8.80 and under 1/			182,913
$8.81	-	$10.00	249,953
$10.01	-	$10.50	80,392
$10.51	-	$11.00	67,625
$11.01	-	$12.00	125,962
Total			**706,845**

1/ Pursuant to A.R.S. § 23-363, employers may pay tipped workers a base wage that is up to $3.00 less than the minimum wage.

The amount of workers that would directly benefit from the measure's minimum wage increase may be more than or less than the total listed in the table. The figures include workers of employers that are exempt from the minimum wage and therefore may be overestimated. The JLBC Staff does not have data on the number of workers of exempt employers.

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However, the figures also exclude workers in certain occupations for which detailed hourly wage data is not available and therefore may be underestimated. The estimates also do not reflect the number of workers making above $12.00 an hour that could indirectly benefit from any adjustments employers may make to pay scales as a result of a minimum wage increase.

There is considerable academic research on the effect of minimum wage increases on employment. As noted by the federal Congressional Research Service in their review of the academic literature, though, the research's "findings are often contradictory." Researchers have attempted to summarize findings of the literature through "meta-studies," which review the estimates from a wide range of academic articles.

Authors of a 2007 meta-study of over 100 articles found that about two-thirds of the papers included estimates that past minimum wage increases lowered employment of low-skilled workers to some degree. Authors of a separate 2009 meta-study analyzed the findings of 64 articles, after making adjustments to remove what they determined were statistical flaws in the initial results. This meta-study found that the impact of increases to the minimum wage on employment in the U.S. has been insignificant.

Furthermore, other studies have found that employment's responsiveness to wages may vary by region, place in the business cycle, the amount of the minimum wage increase, and whether the minimum wage increase is implemented at once or over time through regular adjustments for inflation. Available studies also do not necessarily replicate Proposition 206's specific minimum wage proposal. As a result of all these factors, the impact that Proposition 206's minimum wage increases would have on employment in Arizona is highly uncertain.

<u>Impact on Consumers</u>
Consumers may also be affected by the proposed minimum wage increase if businesses 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 academic minimum wage studies do not generally attempt to quantify the overall state revenue impact of a minimum wage increase. As noted below, a higher minimum wage could theoretically affect state individual income and corporate income taxes and sales taxes, in opposite directions. As a result, it is difficult to determine the overall impact on state revenue collections in advance.

Individual Income Tax
Those employees receiving a higher wage may also pay a 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.

Proposition 206 may also affect the number of taxpayers that claim certain income tax credits provided in statutes. These tax credits – the $25 credit for the 0.6% Proposition 301 sales tax (A.R.S. § 43-1072.01) and the $40 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 by raising product prices, reducing other labor costs (e.g., non-wage benefits), and/or substituting capital for labor through automation.

Sales Tax
Those individuals that would benefit from the proposed state minimum wage may have a higher disposable

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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.

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) and Department of Economic Security programs in which eligibility is determined by income level. This impact has not been determined.

Under Proposition 206, the state government as an employer would remain exempt from paying the minimum wage. The state may be impacted, though, through its contracts with companies employing non-state workers. If contractors' wages are below $12.00 an hour, state contracted costs may increase as contractors raise wages. For example, 50% of home health aides in Arizona were paid wages of $10.70 or less in 2015. These workers would receive wage increases under Proposition 206, which may increase the rates that the state pays for Medicaid home and community based services.

If employers violate the minimum wage requirements, the state Industrial Commission will collect additional civil penalties. The additional amount of civil penalties collected will depend on the level of compliance.

Paid Sick Leave Provisions

There is significantly less academic research on the impacts of paid sick leave requirements than of minimum wage requirements. Many of the economic and fiscal impacts of paid sick leave requirements under Proposition 206, though, are expected to be similar to, but likely smaller than, those described under the *Minimum Wage Provisions* section.

An increase in sick leave use resulting from Proposition 206 may increase business labor costs as additional non-wage compensation is needed for employers to purchase a given amount of labor hours. To offset added labor costs, businesses may attempt to raise product prices, reduce wages of employees that make above the minimum wage, and/or substitute capital for labor through automation. Some of the initial labor costs of increased use of paid sick leave may also be offset by improved employee health from lower transmission of contagious diseases and lower employee turnover. Any changes to wages, employment, prices or profits resulting from Proposition 206's sick leave provisions could indirectly impact state revenue collections of individual and corporate income tax and sales tax.

Under Proposition 206, the state government as an employer would be exempt from paid sick leave requirements. The JLBC Staff currently lacks information as to the extent the state employs contractors which provide levels of sick leave that are below those required under Proposition 206. If contractors offer less than the minimum required benefit, state contracted costs may increase as labor costs of contractors rise.

As with the minimum wage requirements, if employers violate the paid sick leave requirements, the state Industrial Commission will collect additional civil penalties. The additional amount of civil penalties collected will depend on the level of compliance.

Proposition 206 would allow the state Industrial Commission to implement a public education program to inform individuals about paid sick leave requirements available under the measure. The agency does not have an estimate of the costs of implementing such a public education program.

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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 wage and paid sick leave provisions impact income tax revenues, these distributions could change starting in FY 2019. State sales tax revenues are also shared with local government. Any change in these collections resulting from Proposition 206 would impact distributions to cities and counties starting in FY 2017.

Unlike the state government, Proposition 206 requires political subdivisions to pay the increased minimum wage rate and provide minimum levels of paid sick leave. Therefore, subdivisions may incur additional employee payroll costs.

If labor costs of contractors increase as a result of Proposition 206, political subdivisions may also incur additional contracting costs.

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