Analytics

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State Senator Darius Brown has proposed additional minimum wage increases on top of the increase from the last legislative session. These proposed increases are substantial, raising the Delaware minimum wage from $9.25 to $11.00 in 2020 and then adding $1.00 every year after until a $15.00 minimum wage in 2024. An extraordinary increase of 16% per year.

While many legislators see the minimum wage increase as an important helping hand to the working poor, others see it has an untenable burden to Delaware businesses. What does the extensive economic literature predict will be the consequence of such a substantial hike in Delaware's minimum wage?

There are three issues most studied with regard to increases in the minimum wage: The Employment Rate, Consumer Prices, and the Impact on the Poor.

Starting with the employment rate, the National Bureau of Economic Research found that a minimum wage increase led to reduced job growth immediately as well as continued reduction in job growth over time. Other research studies found that there is a trade-off between higher wages and the employment rate, such that for every 10% increase there is in the minimum wage, teenage employment decreased by 1-3%. Although, recent studies in the Quarterly Journal of Economics found that the negative impacts are negligible because businesses will automatically adjust within the next 3-6 years and the decrease in employment rate is so small that it could just be due to variation or selective sampling.

Rapidly raising the minimum wage increases costs to business. As the price for labor increases because of higher wages, the demand for labor decreases. Businesses adjust to by either reducing their work force (discussed above), substituting higher productivity workers for less skilled workers, raising prices, or shutting down the business.

The research literature shows that the most common business response, aside from shedding employees, is to substitute more productive employees for minimum wage workers and to raise the prices of their goods or services.

According to the research, a majority of the costs of increasing the minimum wage is felt by the consumer. In a study by the American Economic Review on the minimum wage increases, economists found that the costs of increasing minimum wage are split 75% to the consumers and 25% to the businesses. Furthermore, when the federal minimum wage increased between 2007-2009, economists found that for an increase of 10% in the minimum wage, prices would increase by 3%.

Finally, loss of employment and the increasing consumer prices impact the poor. Advocates argue that increasing the minimum wage would decrease wealth inequality and that it would increase people's abilities to pay for necessities. However, there are key factors people are understating.

Unlike unemployment or disability benefits the minimum wage is taxable—therefore the increase will not be in full effort and there will be some loss in efficiency. Furthermore, in the United States only 2.1% of paid hourly wage workers have a job that pays at or below the minimum wage. Nearly half of these workers are ages 16 to 24 and more than half of them work part-time and work in food services. A majority of them are in households that do not fall below the poverty level. Due to the tax systems and the social benefit programs, the argument of helping the poor is a weak one at its best—politicians should be focused on reforming the tax and welfare systems rather than the market.

The impact of a minimum wage hike will vary by industry. Those industries where it is difficult to substitute capital (machines, technology) for labor will make larger cuts in employees (e.g., nursing homes). Likewise, industries that sell goods and services outside the minimum wage jurisdiction, will quickly be at a cost disadvantage. Finally, industries that face substantial competition where there is sensitivity to price increases will suffer losses of customers and revenue (e.g., supermarkets).

In summary, the research literature demonstrates that the rapid increase in the Delaware minimum wage proposed by Senator Brown will reduce the demand for minimum wage workers, lead businesses to substitute more skilled workers for current minimum wage employees, and force consumers to pay higher prices for goods and services. To minimize theses effects, research recommends at least three years for every 10% increase in the minimum wage.

Changes in the minimum wage must also make allowance for the fact that approximately half of those paid at or below the minimum wage are young people and are working in jobs where tips are expected. A low starting wage encourages businesses to take a chance on hiring inexperienced young persons and tips in restaurants keep menu prices competitive while raising the wages of servers.

Finally, Delaware's minimum wage does not appear to be off pace with the average state and Delaware's economy is lagging. Over the last decade the average increase in the minimum wage across states was 31%, while Delaware increased 29%. Over the last five years the average minimum wage increase across states was 14%, while Delaware increased 12%.

Currently, according to the Philadelphia Fed's leading index, Delaware is facing a recession in the second quarter of 2020. Delaware's unemployment rate is rising as the number of individuals seeking work is increasing faster than available jobs. And the State Department of Labor's long-term projection of annual employment growth remains at 0.6%.

The economic conditions in Delaware don't warrant an aggressive increase in the minimum wage.

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