



Indexing the Minimum Wage to Inflation: A Cure for What Ails Minimum Wage Policy Making

Wisconsin’s minimum wage recently rose to \$6.50 per hour. It will increase to \$6.55 next summer and to \$7.25 in July of 2009 due to federal law. Current debate is focused not on the level of the wage itself, but on whether the minimum wage in Wisconsin should be automatically and regularly increased, based on an economic measure such as inflation.

| Scheduled Increases in the Wisconsin Minimum Wage | | |
|---|--------|-------------|
| Date | Wage | Source |
| Currently | \$6.50 | State law |
| July 2008 | 6.55 | Federal law |
| July 2009 | 7.25 | Federal law |

The Roller-Coaster History of the Minimum Wage

The recently passed increases to the minimum wage were the first in a decade. The purchasing power of the minimum wage had been seriously eroded by inflation since the last increase in 1997 – losing 20 percent of its value since that time.ⁱ In fact, before the increases, the minimum wage was at its lowest inflation-adjusted value in 50 years.

While the 10-year period without a federal increase was one of the longest, it was not unprecedented. Since the inception of the minimum wage in the late 1930s, its history has been one of long periods of neglect and declining purchasing power, followed by abrupt and often significant increases.

This pattern results in a number of negative outcomes, from less buying power from year to year for those earning the low wage, to irregular spikes in labor costs for employers of low wage workers.

With no regular increases to the wage set in law, the minimum wage debate reappears every few years and quickly becomes partisan. The discussion is largely driven by the prevailing political winds, and the outcome rarely turns on economic and labor market data, productivity gains, or overall wage trends.

In a 2006 issue of *US Economics Analyst*, Goldman Sachs Vice President Andrew Tilton summed up the situation and concluded the following:

“Regardless of one’s view on the desirability of the minimum wage, its current implementation has two clear problems: the periodic debates

about raising the wage consume politicians' (and economists') time and energy, and the unpredictability of the law – irregular large hikes followed by gradual erosion through inflation – makes business planning more difficult. If a minimum wage is desired, indexing it to inflation would avoid these problems.^{xi}

States Increasingly Turn to Indexing

Officials in ten states have responded to these problems by indexing their minimum wages to inflation.

Indexing ensures that the wage does not lose its purchasing power and brings predictability to those businesses paying its workers the minimum wage. While employers must account for the

annual increase – as they must account for regular increases in other costs of doing business – they know at least that the wage is not likely to be subject to an abrupt and significant change. In other words, as Andrew Tilton suggests, they can plan for it.

| States with a Minimum Wage Indexed to Inflation | |
|--|------------|
| Arizona | Nevada |
| Colorado | Ohio |
| Florida | Oregon |
| Missouri | Vermont |
| Montana | Washington |

The move toward indexing should not surprise us given the high number of tax and benefit related programs that are already linked to inflation in many states, including Wisconsin. Here, the state (and federal) Earned Income Tax Credit, the standard tax deduction along with our tax rate brackets are all indexed to inflation. So are many of our benefit programs such as medical assistance, food stamps, and our subsidized child care program, Wisconsin Shares.

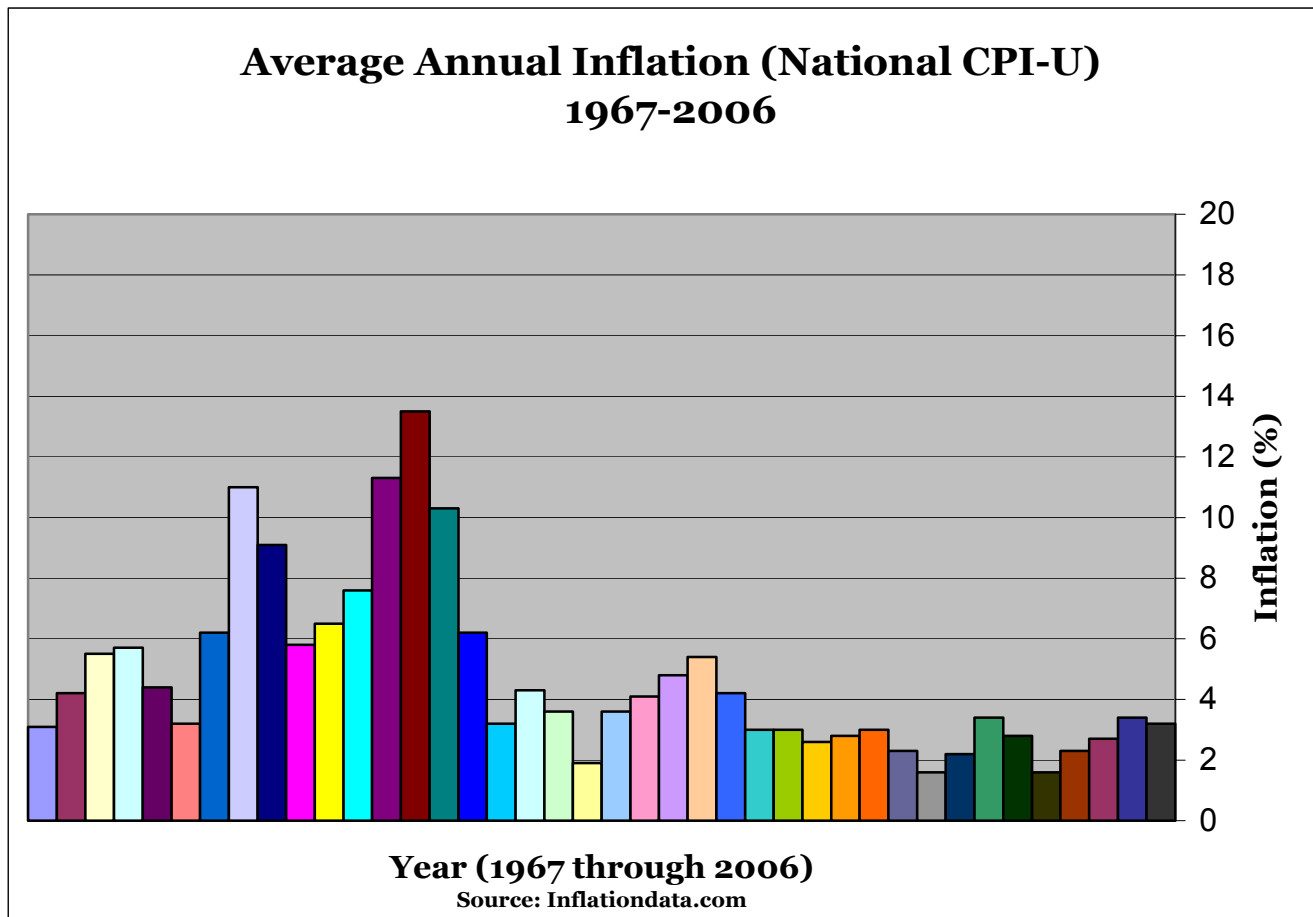
Indexing Would Result in Reasonable Increases

A common response to proposals to index the minimum wage to inflation is a fear that a period of inordinately high inflation will skew labor market decision-making by causing the mandated minimum wage to increase faster than overall wages in the economy.

As recently pointed out by economist Michael Ettlinger of the Economic Policy Institute, this is unlikely to occur.ⁱⁱⁱ If the minimum wage had been indexed to inflation for the past 50 years, the value of that wage would have increased by 740 percent during that time. Average wages, meanwhile, rose by over 920 percent during that same time period. Increases in a minimum wage stemming from indexing will lag behind growth in average wages in most individual years, and have, obviously also done so over a long period of time.

In recent years, as indicated in the chart below, inflation has been tame, between 1.6 and 3.4 percent during the last ten years (and averaging 2.55 percent during that time). If one goes back much farther, it is possible to find higher rates of inflation, for instance, reaching the double digits for three straight years from 1979 to 1981 (11.3, 13.5, and 10.3 percent respectively).

Over the last quarter century, however, inflationary pressures have been mild, averaging 3.25 percent since 1967. The following chart shows the national rate of inflation over the last thirty years.



Conclusion

The current policy making process surrounding the minimum wage results in highly politicized debates, a significant loss of purchasing power for those earning it during the long periods of neglect, and unpredictability for those employing workers at this wage – businesses that are eventually confronted with sudden and some times significant increases in the wage.

Amending current law to index the state minimum wage to inflation will help on all fronts: (1) it will help maintain purchasing power for our lowest wage workers, (2) it will bring more predictability to those employing workers at the minimum wage, and (3) it will spare us all the rancor of a partisan and polarizing debate – the outcomes from which rarely turn on sound public policy considerations.

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ⁱ Jared Bernstein and Isaac Shapiro. *Buying Power of Minimum Wage at 51 Year Low: Congress Could Break Record for Longest Period without an Increase*. Center on Budget and Policy Priorities. June 20, 2006. Available online at <http://www.cbpp.org/6-20-06mw.htm>.

ⁱⁱ Andrew Tilton. *A Minimum Wage Hike: Big Micro, Small Macro Effects*. US Economics Analyst, Issue No. 06/46. November 17, 2006.

ⁱⁱⁱ Michael Ettlinger. *Securing the Wage Floor: Indexing Would Maintain the Minimum Wage's Value and Provide Predictability to Employers*. Economic Policy Institute. EPI Briefing Paper #177. October, 2006. Available online at <http://www.epi.org/content.cfm/bp177>.