December 9, 2005

Hon. Bill Lockyer
Attorney General
1300 I Street, 17th Floor
Sacramento, California 95814

Attention: Ms. Tricia Knight
Initiative Coordinator

Dear Attorney General Lockyer:

Pursuant to Elections Code Section 9005, we have reviewed the proposed statutory initiative regarding the minimum wage (File No. SA2005RF0112, Amdt. #1-S).

KEY PROVISIONS

The measure would increase the state minimum wage from the current $6.75 per hour to $7.50 per hour effective January 1, 2007, $8.25 per hour effective January 1, 2008, and $8.75 per hour effective January 1, 2009. In addition, the measure would require the state to adjust annually—beginning January 1, 2010—the minimum wage rate based on inflation.

Currently, most categories of employees are subject to the state minimum wage provisions. However, self-employed workers and professional and managerial workers are generally exempt from state and federal minimum wage laws.

FISCAL IMPACT

Impact on the Economy

This initiative would raise California's minimum wage by 30 percent and then index it to keep up with inflation. An increase of this magnitude would have some effects on California's economy. These impacts are discussed below.

Effects on Businesses. The minimum wage increase proposed by this measure would result in higher wage costs for businesses. Businesses would attempt to compensate for these higher costs by such means as raising prices, reducing other costs (including nonwage benefits to their employees), and/or scaling back their use of labor through automation. Businesses not able to compensate for the higher costs would face a reduction in profits and some could reduce operations in California. Overall, the measure would likely result in some decline in employment and business activity in the state relative to what would otherwise have occurred.

Effects on Low-Wage Employees. This measure would have varying effects on low-wage workers. Specifically:

- Those workers making less than the new minimum wage level would experience pay increases and thus would have more income.
- Given the potentially adverse impacts on businesses discussed above, however, some low-wage workers could find fewer job opportunities available. These individuals would experience a reduction in income.

Effects on Consumers. In some cases where businesses were able to "pass along" part or all of the wage increase, the resulting increases in product prices would leave consumers and other businesses with less income and less profits than otherwise.

Impact on State and Local Revenues

The economic effects described above would have offsetting factors on state and local revenues. Factors *raising* revenues include the following:

- The increase in income for certain low wage employees would lead to some increases in the personal income tax.
- To the extent that this higher income were spent on taxable goods, the sales tax could also rise.
- Finally, in cases where the higher minimum wage is passed along by businesses to their customers in the form of higher product prices, the sales tax on those products would also increase.

However, these gains would likely be more than offset by the negative impacts of the minimum wage increase on profits, employment, and spending in other areas of the economy. Specifically:

- To the extent that higher wage costs reduced business profits, personal income taxes and corporate tax receipts would decline. This is significant because the average income tax rate on foregone business profits would generally be higher than the personal income tax rate on minimum wage employees' wage increases.
- To the extent that the wage increases were passed along by businesses to their customers in the form of higher product prices, consumers and businesses

purchasing the higher-priced goods would have less discretionary income for other purchases, resulting in less sales taxes from them.

- To the extent that the higher minimum wage resulted in less employment and economic activity in the state, taxes from a variety of sources would decline.

On balance, the economic and revenue factors described above would likely result in some net decline in state and local government revenues. In the context of overall state and local government revenues, any impact would probably be modest.

Impact on Public Sector Expenditures

Program-Specific Costs. State and local governments provide various services—primarily in the health and social services areas—using low-wage, private sector employees:

- ***State Payments to Providers.*** The state would make higher payments through the Department of Developmental Services for community-based service providers, totaling approximately $60 million annually.
- ***In-Home Supportive Services (IHSS).*** The state would experience initial costs of about $20 million, rising to about $45 million in 2008-09 for wage increases for service providers working at or near the minimum wage. State costs for the IHSS program would continue to increase annually until the minimum wage reaches the statutory cap for which the state participates in IHSS wages and benefits, which is currently $11.10 per hour. Counties would face initial costs of about $5 million, rising to $25 million in 2009-10 and thereafter.
- ***Medi-Cal Costs.*** Higher costs for hospital care paid through Medi-Cal would be unknown but significant. In addition, the measure could result in increased Medi-Cal nursing home expenditures of a few million dollars annually beginning in 2008-09.
- ***Child Care Programs.*** Increased state costs for child care programs administered by the Departments of Education and Social Services could potentially be in the low tens of millions of dollars annually, due to increased wages of care providers.

Costs and Savings to Health and Social Services. To the extent the number of lower-wage job opportunities, and therefore employment, decline as a result of the measure, state and local governments could incur additional costs to provide various health and social services to the unemployed. These services include the Medi-Cal program, the California Work Opportunity and Responsibility to Kids program, and indigent health care services. The additional costs of these services are unknown.

These additional costs would be offset, to an unknown extent, by savings that result from reduced benefit levels provided to those who receive public assistance. This is because the increase in minimum wage would cause work earnings of program beneficiaries (or potential beneficiaries) to rise, thus lowering the benefit levels for which they are eligible.

Public Employee Costs. The increases in the minimum wage would directly increase costs to state and local governments for those employees making less than $8.75 per hour. There are relatively few public sector employees who make less than this amount. We estimate that added costs for these employees would be in the millions of dollars annually.

Other Cost Impacts. The higher minimum wage would increase state and local government costs in a number of other ways. For instance, to the extent that the measure results in a slight increase in inflation—as many studies suggest happens—the public sector could incur added costs for expenses indexed for inflation, such as certain welfare payments and building leases.

Summary of Fiscal Effects

This measure's increase in the minimum wage would result in the following fiscal effects on state and local governments:

- Potential modest net reduction in annual state and local government revenues.
- Annual state and local governmental costs—primarily in health and child care programs—potentially in the low hundreds of millions of dollars.

Sincerely,

Elizabeth G. Hill
Legislative Analyst

Michael C. Genest
Director of Finance