January 8, 2014

Hon. Kamala D. Harris
Attorney General
1300 I Street, 17th Floor
Sacramento, California 95814

Attention: Ms. Ashley Johansson
Initiative Coordinator

Dear Attorney General Harris:

Pursuant to Elections Code Section 9005, we have reviewed a statutory initiative that proposes increases in California's minimum wage above those already scheduled in state law (A.G. File No. 13-0050).

BACKGROUND

Statewide Minimum Wage Currently $8 Per Hour. California's statewide minimum wage is currently $8 per hour. In addition to the statewide wage requirement, higher minimum wages have been established by a small number of local and tribal governments.

History of California's Minimum Wage. The state has set its minimum wage higher than the current federal minimum wage of $7.25 per hour. The minimum wage has been adjusted periodically over time. Although the "nominal" dollar amount of the minimum wage in California has never declined, it has often grown more slowly than inflation.

Minimum Wage Already Scheduled to Increase Under a New Law. Under a new law signed by the Governor on September 25, 2013, the statewide minimum wage already is scheduled to increase to $9 per hour on July 1, 2014 and to $10 per hour on January 1, 2016.

Applicability of Minimum Wage Laws. Most categories of employees are subject to the state minimum wage. However, self-employed workers and salaried workers are generally exempt from state and national minimum wage laws.

PROPOSAL

Measure Proposes Increases to California's Minimum Wage. This proposal makes two changes in the state's minimum wage law. First, it increases the statewide minimum wage to $10 per hour on March 1, 2015 (ten months earlier than scheduled under current law). Second, California's statewide minimum wage would subsequently rise to $12 per hour on March 1, 2016.

Minimum Wages in Other States. The already-scheduled increase to $10 per hour would raise California's minimum wage to a level higher than any current statewide minimum wage in the United States. Washington currently has the highest statewide minimum wage at $9.32 per hour—a minimum wage level that rises every year based on inflation. This measure's proposed increase to $12 per hour likely would widen the gap between California and other states. (Between now and 2016, other state governments or the federal government could decide to raise their minimum wages.)

California's Lower-Wage Workforce. Based on federal data sources, we estimate that roughly one half of California's workers are paid on an hourly basis. Of these hourly workers, fewer than half earn less than $12 per hour. Among hourly workers making less than $12 per hour, half are older than 30, more than a third have some college education, and around half work more than 35 hours a week. Hourly workers making less than $12 per hour tend to be concentrated in service-oriented industries, particularly educational and health services, leisure and hospitality, and wholesale and retail trade.

FISCAL EFFECTS

Except where otherwise noted, the state and local government fiscal impacts described in this analysis primarily relate to the ongoing annual effects of the proposed increase from $10 per hour to $12 per hour. The ten-month acceleration of the increase from $9 per hour to $10 per hour would likely have much smaller and shorter-lived effects. The proposed increase to $12 per hour—combined with the effects of the already-scheduled minimum wage hikes—would likely result in economic and fiscal changes of a greater magnitude than those associated with prior changes in the minimum wage. That being said, certain key economic and revenue effects of this measure itself—along with some state and local spending effects driven by economic factors—likely would be temporary in duration. That is because, over time, inflation and related factors likely would drive many workers' wages to the levels required by this measure even if its proposed minimum wage increases were never passed into law.

Effects on Economy

This proposal would raise wages for low-wage workers, but it would also affect California's economy in many other ways. For example, a higher minimum wage would lead to higher product prices in industries that employ many low-wage workers, such as the restaurant industry. A higher minimum wage could also lead to changes in nonwage benefits, hiring, employee turnover, productivity, business profits, capital investment, consumer spending, and other economic activities. Economic research indicates that the magnitudes of these economic effects are uncertain and that these effects could interact in complex ways. For example, employment could decline if employers responded to higher labor costs by hiring fewer workers. On the other hand, employment would change very little if reductions in hiring were largely offset by lower employee turnover or if some combination of nonwage benefit reductions, price increases, productivity increases, and profit reductions offset higher wage costs. Overall, this proposal would likely reduce the growth rate of California's aggregate economic output to some extent, particularly in the first several years after its passage.

Effects on State and Local Revenues

This proposal could affect many state and local revenue sources—most notably the state personal and business income taxes and sales taxes of both state and local governments.

Likely Reduction in State Income Tax Revenue. The proposal would likely reduce state revenue from income taxes—the state government's largest revenue source. (This likely reduction—like all of our fiscal estimates—is the change that would result from the proposal. It does not necessarily imply that total income tax revenue would decrease from one year to the next.) The higher minimum wage likely would raise incomes of some low-wage workers but potentially reduce incomes of some higher-income households. Higher-income Californians who own certain businesses, for example, may receive less income from those businesses due to higher wage costs. In California, higher-income households pay higher marginal personal income tax rates, so the net effect of these changes likely would be a reduction in state income tax revenue. In total, the reduction to the state's income tax revenues could total a few hundred million dollars annually.

Uncertain Changes in State and Local Sales Tax Revenue. State and local government sales tax revenues depend on the level of taxable sales, which is the total dollar value of all taxable goods sold in California. A higher minimum wage could lead to higher taxable sales (which would increase revenue) or to lower taxable sales (which would reduce revenue). For example, the potential income changes described above could lead some low-wage workers to increase their spending while leading some higher-income households to reduce their spending. The net effect of these changes on sales tax revenue would depend both on the relative magnitude of those income changes and on each group's propensity to spend on taxable goods.

A higher minimum wage would also lead to higher product prices for some goods and services. The effect of these price increases on taxable sales would primarily depend on three factors: (1) the magnitude of the price increases, (2) the strength of consumer responses to the price increases, and (3) the extent to which the affected industries sell taxable goods. To illustrate, consider a case in which the price increases would be disproportionately concentrated in industries that sell taxable goods. If consumer responses to those price increases were relatively weak, then those price increases would lead to higher taxable sales, as the price increases would outweigh reductions in the quantity of goods sold. On the other hand, if the consumer response to those price increases were relatively strong, the reductions in the quantity of goods sold could outweigh the price increases. Furthermore, a reduction in business activity arising from a strong consumer response could also lead to hiring reductions, which would reduce spending by the affected households.

Given these complex and highly uncertain economic effects, this measure's potential effects on state and local sales tax collections are also uncertain. In our view, sales tax revenue gains are somewhat more likely than sales tax revenue losses.

Overall Net Change in State and Local Revenues Uncertain. Given the uncertainty described above concerning sales tax collections, this proposal's net effect on combined state and local revenues is uncertain, with total gains or losses resulting from this measure potentially totaling hundreds of millions of dollars per year.

The timing of these revenue effects is also uncertain. On the one hand, businesses could start responding to the proposed policy change as soon as they became aware of it, long before the change would actually occur. On the other hand, it could take time for California's economy to adjust to the new minimum wage, leading to lagged effects. As noted above, to some extent, these effects could be temporary, given that inflation and related factors generally would increase many workers' wages over time, even if this measure were never passed into law.

Effects on State and Local Government Spending

State Revenue Changes Would Affect School and Community College Funding. Proposition 98—a state constitutional provision—requires that a minimum level of funding be provided each year to the state's public schools and community college districts. In general, increased state revenues result in a higher Proposition 98 minimum funding guarantee, while lower state revenues result in a smaller minimum funding guarantee. Accordingly, to the extent that this measure results in higher collections of state tax revenues, higher guaranteed school funding also would tend to result. To the extent that this measure results in lower collections of state tax revenues, lower guaranteed school funding would tend to result.

Public Employee Costs. State and local governments currently employ workers who make less than $12 per hour. This proposal could directly increase costs for those employees, depending on the extent to which state and local governments alter nonwage benefits in response to the wage increase. The wage increase for workers now earning less than $12 per hour could also exert upward pressure on wages for higher-paid employees, which would lead to higher costs. Costs would start to increase in the 2014-15 fiscal year and would continue to increase before plateauing in the 2016-17 fiscal year. By 2016-17, the state could face increased annual costs of tens of millions of dollars, while local governments could face increased annual costs in the low hundreds of millions of dollars.

Health and Social Services Program Costs. This proposal would affect state and county expenditures on health and social services programs largely due to its potential effects on families' incomes. Additional income resulting from higher wages could reduce the number of benefit recipients or the benefits they receive, generating savings for these programs. On the other hand, if the higher minimum wage reduced employment, then these programs could incur higher costs. As a result, the proposal's net fiscal impact on these programs is highly uncertain. It could increase or decrease overall state and local government costs for these programs by hundreds of millions of dollars per year, with net savings more likely than net cost increases.

Other Program-Specific Costs. This proposal could affect many public programs, particularly those that pay certain service providers. These programs include:

- ***Payments to In-Home Supportive Services Providers (IHSS).*** The IHSS program provides personal care and chore services to low-income aged, blind, or disabled persons in order to help them remain safely in their own homes. The proposal would increase state costs for payments to IHSS service providers by a total of hundreds of millions of dollars annually by 2016-17, with smaller increases in prior fiscal years.

- ***Payments to Developmental Services Providers.*** The state's Department of Developmental Services provides services to California residents with developmental disabilities. The proposal could increase the state's annual payments to community-based service providers by hundreds of millions of dollars by 2016-17, with smaller increases in prior fiscal years.

- ***Child Care Programs.*** The state subsidizes child care services for some low-income working families by issuing vouchers and by contracting directly with child care providers. Under current law, a minimum wage increase would not automatically require increased state expenditures on child care. A higher minimum wage, however, could cause child care providers to charge higher rates to cover their increased costs. The state might respond by choosing to raise voucher amounts or reimbursement rates, leading to higher state costs. Overall, this proposal's net fiscal impact on state child care costs is uncertain.

- ***Administrative Costs.*** The state's Department of Industrial Relations (DIR) enforces various labor laws. Raising the minimum wage would cause DIR to incur a one-time administrative cost in the low to mid hundreds of thousands of dollars, which would likely be funded by fees currently levied on California employers.

Summary of Fiscal Effects

This measure would have the following major fiscal effects:

- Increase or decrease in state and local tax revenues of uncertain magnitude, potentially totaling hundreds of millions of dollars per year. Changes in state revenues would affect the amount of required state funding for schools and community colleges.
- Increase in state and local government costs for service providers and government employees potentially totaling in the high hundreds of millions of dollars per year.
- Potential increase or decrease of hundreds of millions of dollars in other annual state and county expenditures on health and social services programs, with net savings more likely than net cost increases.

Sincerely,

Mac Taylor
Legislative Analyst

Michael Cohen
Director of Finance