

BRIEF ANALYSIS

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Health Insurance and the Minimum Wage

Political support is growing in Congress for another increase in the federal minimum wage. Bills now under consideration would raise the minimum hourly wage by \$1, from \$5.15 to \$6.15, in two steps over the next year and a half. According to the Economic Policy Institute, about 11.8 million workers would be affected by a minimum wage increase. Although many of these are teen-agers and part-timers, almost one million are single mothers.

What are the likely consequences? Economists have traditionally warned that a higher minimum wage causes more people to be unemployed. But recent studies point to an even more serious consequence: fewer fringe benefits, including health insurance.

Congress can avoid adding to the ranks of the uninsured by giving employers and employees the option of using the amount of the minimum wage increase for health insurance in lieu of wages.

Wages vs. Other Benefits. Economic theory teaches that workers tend to get paid a wage equal to the value of what they produce. So employees who produce \$5.15 worth of goods and services per hour will tend to be paid \$5.15. But what happens if the law makes employment illegal unless the wage is at least \$6.15 per hour? No employer is going to pay \$6.15 for \$5.15 worth of productivity. So employers and employees will seek ways around the law — by reducing nonwage compensation. [See Figure I.] In particular, to offset the \$1 increase in hourly wages, employers will tend to reduce

by \$1 the amount they spend on such fringe benefits as vacation time, health insurance, holiday pay, employee discounts, uniforms, credit toward college tuition, etc. Other ways of reducing labor costs by \$1 include spending less on working conditions and employee training costs. Employers may also impose more rigorous work requirements, insisting that employees work faster or work harder.

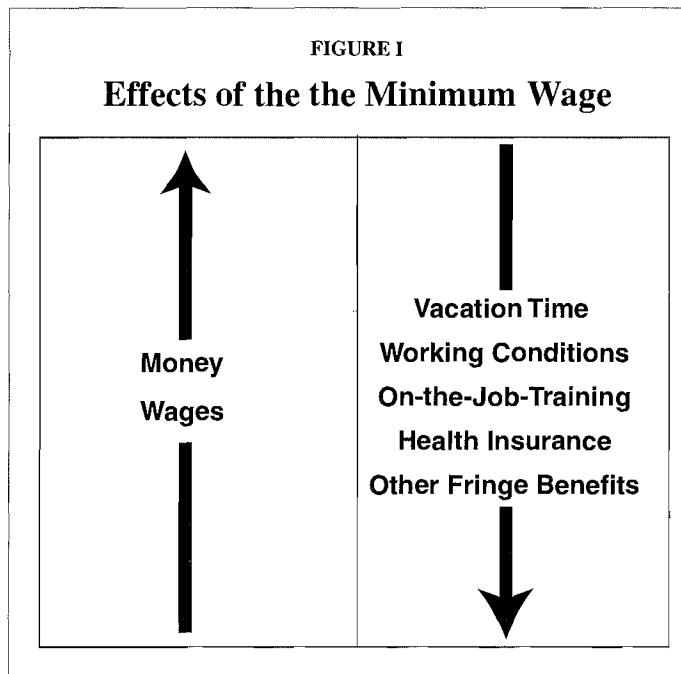
The net effect of these adjustments is to largely neutralize the cost impact of the minimum wage hike.

For example, when the minimum wage increases by \$1, the cost of labor may, on balance, rise by only 5 cents. Workers who retain their jobs are unlikely to be any better off than before. They get more money, but they also get fewer fringes and have to work harder for their pay. A host of studies confirm this result.

■ A 1982 study by Ohio State University labor economist Masanori Hashimoto found that under the 1967 minimum wage hike, employees gained 32 cents per hour in

money income but lost 41 cents per hour in on-the-job training (a net loss of 9 cents per hour in total compensation).

- Economists Linda Leighton and Jacob Mincer concluded in a 1981 study for the American Enterprise Institute that minimum wage increases reduce on-the-job training and, as a result, dampen growth in the real long-run income of covered workers.
- Three other separate studies have concluded that minimum wage increases lead to large reductions in fringe benefits and to worse working conditions.



What happens if employers can't reduce fringe benefits (say, because there are none) or are unable to make other adjustments? Then employees are in danger of losing their jobs. For example, after a minimum wage increase in New York, Walter Wessels, an economist at North Carolina State University, found that 4,827 stores reduced the number of workers, the hours they worked or both.

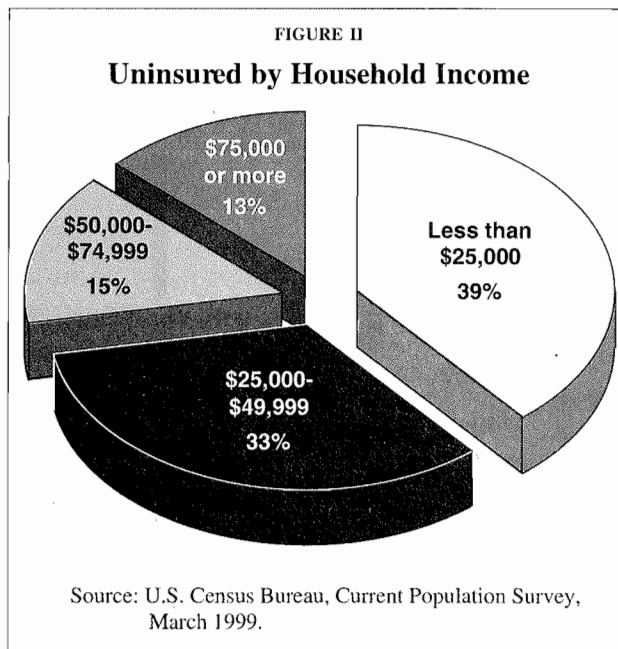
Most empirical studies have found that a 10 percent increase in the minimum wage lowers the employment of teen-agers (the group of workers most likely to be adversely affected by the minimum wage) by anywhere from 0.5 percent to 3 percent. With about eight million teen-agers in the workforce, this implies that a \$1 increase in the minimum wage would result in as many as 240,000 more unemployed teen-agers.

Wages vs. Health Insurance. One of the most important employer benefits that substitutes for money wages is employer-provided health insurance. In a recent study for

the Board of Governors of the Federal Reserve System, economist Louise Sheimer concluded that in most cases the trade-off is dollar for dollar. Thus, for low-paid employees with health insurance, a \$1 per hour increase in the minimum wage could result in a \$1 per hour decrease in employer-provided health insurance. Many single mothers — as well as others — employed at or near the current minimum wage are among the working poor. As Figure II shows, those earning lower wages are already more likely to lack health insurance. An increase in the minimum wage will induce even more employers to drop or reduce health insurance benefits, resulting in a further increase in the number of uninsured.

Solution: Creating an Option for Employers. If there is an increase in the minimum wage, employers should be able to count the amount of the increase against spending on health insurance for their employees. This option would allow an employer to substitute a nontaxable benefit for taxable wages. For a person working 2,000 hours per year, a \$1 increase in the minimum wage would amount to \$2,000, enough to purchase an individual health insurance policy in most places. A couple, both working at the minimum wage, would have a wage increase of \$4,000, enough to purchase a family policy in most places.

Solution: Creating an Option for Employees. Employees should also have the option of applying the minimum wage increase to their expenses for health insurance. Employers who do not provide health insurance could set up a flexible spending account for employees at minimum cost. Employees could then use (potentially) taxable wage income to purchase



nontaxed health insurance instead.

Insuring the Uninsured. Market forces will largely neutralize the impact of a minimum wage increase, and the minimum-wage employee is unlikely to be much better off than before the increase. However, if the health insurance option is part of the legislation, it offers an opportunity to reduce rather than increase the number of Americans without health insurance.

This Brief Analysis was prepared by Richard McKenzie, professor in the Graduate School of Management at the University of California, Irvine, and NCPA President John C. Goodman.