

## MINNESOTA FAIR LABOR STANDARDS ACT & WAGE MANDATES BACKGROUND

**Minimum wage:** Effective July 24, 2007, the federal minimum wage increased from \$5.15 to \$5.85 per hour. Additional increases are scheduled in 2008 and 2009. Since Minnesota has different minimum wages for large and small businesses, the minimum wage for small employers rose, but the wage for large employers did not change (see table below).

States are allowed to set their minimum wage rates above or below the federal level; however, the law most favorable to the employee takes precedence. The federal minimum wage applies to businesses with less than \$500,000 in annual sales. Minnesota sets separate minimum wages for large and small businesses. State law defines small businesses as having annual sales under \$625,000.

### New Minimum Wage(s) & Effective Dates

| Date              | Federal Minimum Wage | Current Law for MN Small Employers (under \$625K) | New Rates for MN Small Employers (under \$625K) | Current Law for MN Large Employers (over \$625K) | New Rates for MN Large Employers (over \$625K) |
|-------------------|----------------------|---|---|--|--|
| 7/24/07 – 7/23/08 | \$5.85               | \$5.25  | \$5.85  | \$6.15   | \$6.15   |
| 7/24/08 – 7/23/09 | \$6.55               | \$5.25  | \$6.55  | \$6.15   | \$6.55   |
| 7/24/09 & beyond  | \$7.25               | \$5.25  | \$7.25  | \$6.15   | \$7.25   |

The table above outlines the current federal minimum wage, Minnesota's minimum wage and the new minimum wage effective dates. The table does not apply to Minnesota employers with less than \$500,000 in annual sales that do not engage in interstate commerce.

In 2005, the Legislature increased the minimum wage from \$5.15 to \$6.15 per hour for large employers and from \$4.90 to \$5.25 per hour for small employers. A tip credit amendment was defeated.

According to the Minnesota Department of Labor, in 2005 (the most recent data available), approximately 83,000 workers in the state were making \$6.15 per hour or less. This is down from about 119,000 in 2003, 145,000 in 2001 and 252,000 in 1998. From 1998 to 2003, the percentage of workers making \$6.15 or less in the workforce has dropped from 11 percent to 3.3 percent - a 70-percent decrease. The number of minimum wage workers dropped in all major demographic categories and in all occupational groups signaling that the market has increased wages throughout the economy. The following table shows a demographic breakdown of minimum wage workers.

### DEMOGRAPHIC PROFILE OF MINNESOTA MINIMUM WAGE WORKERS: 2005

| Characteristic     |             | Number in thousands | Percent Distribution |
|--------------------|-------------|---------------------|----------------------|
| <b>Age</b>         | 15 to 19    | 31                  | 37%                  |
|                    | 20 to 24    | 17                  | 20%                  |
|                    | 25 and over | 36                  | 42%                  |
| <b>Work Status</b> | Full-time   | 30                  | 36%                  |
|                    | Part-time   | 53                  | 64%                  |

Source: MN Department of Labor

The Minnesota Department of Labor's report also states that about 46 percent of the current minimum wage workers are employed in the retail trade and restaurant industries. These workers make significantly more than minimum wage when their commissions and tips are included.

Labor market works: An increase in the minimum wage is not necessary because the market has increased wages of employees throughout the economy. Employee productivity gains have been rewarded with increased wages, and the demand for labor will ensure that wage gains are maintained and expanded in the future.

Workers who start at the minimum wage quickly move up the income ladder. On average, the income of minimum wage workers increases 30 percent within one year, according to an Employment Policies Institute analysis of the 1992-1994 Current Population Survey. Furthermore, income mobility studies (Joint Economic Committee/U.S. Treasury Department, the Dallas Federal Reserve Bank, the Urban Institute and Syracuse University economists) show that the U.S. economy is very dynamic. Individuals in the lowest income group were able to move up to at least the middle-income bracket in as little as four years.

Impact of minimum wage increase: Several academic studies have confirmed the view that increasing the minimum wage leads to fewer entry-level jobs and does little, if anything, to help the poor out of poverty. A brief summary of such studies follows:

- The 1998 edition of the Journal of Economic Literature asked labor economists to estimate the impact of increasing the minimum wage. On average, economists believe that a 10-percent increase in the minimum wage reduces youth employment by 2.1 percent.
- In 1999, research titled “Will Increasing the Minimum Wage Help the Poor?” published by the Federal Reserve Bank of Cleveland concluded that the net effect of increasing the minimum wage is an increase in the proportion of poor families. More families fall into poverty because of job loss than benefit from the higher wage.
- A 1998 study found that increasing the minimum wage reduces education and training received by young workers. When workers are not provided education and training and subsequently do not improve their skills, their income potential drops over their entire lifetimes.
- A 2000 study by a Federal Reserve economist concludes that a 10-percent increase in the minimum wage raises the nonaccelerating inflation rate of unemployment (NAIRU) by about half a percentage point. The study further states that in the 1960s and 1970s, increases in the minimum wage were the largest factors in the rise of the NAIRU.
- A 2001 study by two Ohio University economists titled “Does the Minimum Wage Reduce Poverty?” concludes that, in the United States, virtually no meaningful evidence exists that a higher minimum wage rate reduces poverty. The study further concludes that the “key to reducing poverty is getting individuals jobs, and having them stick with those jobs until incomes rise with the higher productivity that comes with on-the-job training and work experience.”
- A 2004 study by economists from Miami University of Ohio and Florida State University titled “Wage Growth Among Minimum Wage Workers” concludes that nearly two-thirds of minimum wage workers receive a raise within a year of starting employment. The wage increases far outpace the raises given to employees earning above the minimum wage.
- A 2006 study by an economist from the University of Georgia titled “The Effect of Minimum Wage Increases on Retail and Small Business Employment” concludes that a 10-percent increase in the minimum wage results in a 2.7- to 4.3-percent decline in teen employment in the retail sector, a 5-percent drop in the average retail hours worked by all teen-agers, and a 2.8-percent decline in retail hours worked by teen-agers who remain employed in retail jobs. In addition, the study shows a 10-percent increase in the minimum wage yields a 4.6- to 9.0-percent decline in teen-age employment in small businesses.

- A 2006 study by two Chicago economists titled “Output Prices and the Minimum Wage” concludes that a 10-percent increase in the minimum wage results in a 2.0- to 2.5-percent drop in employment.

In February 1999, Federal Reserve Chairman Alan Greenspan addressed the minimum wage in testimony to Congress. He commented that increasing the minimum wage probably would push inflation higher, but his main concern was over “individuals who become unemployed because of the minimum wage.” He stated that a minimum wage increase won’t immediately reduce employment; however, when the economy slows, teen-age unemployment will be higher than it would otherwise have been.

Tip credit: At present, 43 states, the District of Columbia and the federal government allow employers to utilize some form of a tip credit. Minnesota is only one of seven states to have never enacted or repealed a tip credit. The minimum wage for Minnesota tipped employees is currently \$6.15 per hour for large employers and \$5.25 per hour for small employers. That compares to Iowa’s and North Dakota’s \$3.45 per hour, South Dakota’s \$2.13 per hour and Wisconsin’s \$2.33 per hour.

Tips are considered wages for the purposes of Social Security taxes, FICA taxes, workers’ compensation insurance premiums and unemployment insurance taxes. In addition, the Internal Revenue Service, the U.S. Department of Labor and the Minnesota Department of Revenue recognize tips as wages. Minnesota’s minimum wage law is the only law facing Minnesota employers in which tips are not considered wages.

State prohibition of local wage rates: Most policy-makers recognize that states which exceed the federal minimum wage create an anti-competitive environment for business that can lead to job and business relocation. Political subdivisions that adopt higher minimum wages than required under federal law create the same anti-competitive environment within a state. Business relocation is even more likely when this occurs, especially in border communities and metropolitan areas.

In 1997, Louisiana passed a prohibition on political subdivisions establishing a minimum wage rate. The Louisiana Supreme Court recently ruled against a court challenge to overturn the law. Michigan also has debated local minimum wage prohibition.

**Overtime:** The federal Fair Labor Standards Act (FLSA) requires employers to pay overtime pay of time-and-one-half the regular rate of pay for all hours worked in excess of 40 hours per week. The act exempts workers employed in executive, administrative or professional capacities or outside salespeople. However, the federal statute did not define the terms “executive,” “administrative” or “professional.” Rather, the U.S. Department of Labor developed several tests to define the exemptions. These tests have not kept up with the modern workplace. Many of the jobs described in the tests no longer exist while new service sector jobs were not contemplated when the tests were last updated. In addition, there has been a significant amount of class-action litigation alleging employers failed to properly apply the exemptions. This led the U.S. Department of Labor to propose the first update of overtime regulations in decades.

The new overtime regulations took effect August 23, 2004. They were designed to modernize definitions, make the act easier to understand and administer and prevent unnecessary litigation. The U.S. Department of Labor estimates that almost 7 million workers will have overtime protections because the new regulations increased the minimum salary level to be exempt from overtime to \$23,660 from \$8,060 annually. Employers will see savings in other areas of the new regulations.

It currently is unclear how the federal and state overtime laws will work together because one feature of the federal FLSA is that the law more beneficial to employees applies. This will make administration of overtime difficult until Minnesota conforms to federal regulations.

In 2004, legislation was introduced to prevent the new federal regulations from taking effect in Minnesota. This legislation also would have caused problems for employers because the law would only prohibit changes in federal regulations that were less generous to employees than Minnesota law.

**Prevailing wage:** The prevailing wage statute in Minnesota, the "little Davis-Bacon" law, was adopted in 1973 as a counterpart to the federal Davis-Bacon Act. The state law provides that a "prevailing wage rate" must be paid on all state or local building and highway construction projects financed in whole or part with state funds.

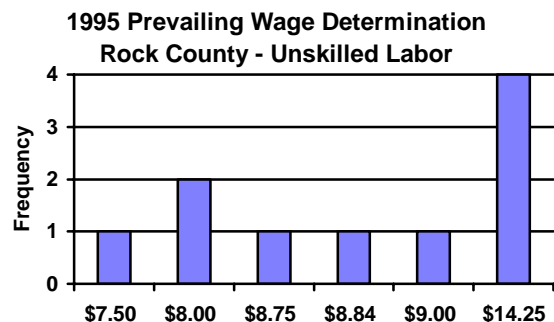
The concept of the prevailing wage law was first adopted in Kansas in 1891. The federal government passed similar legislation during the 1930s. At that time, there was no minimum wage law either at the state or federal levels. It was commonplace to use convict labor recruited through the "shape-up" system, a type of reverse auction in which work was auctioned off to those willing to work at the lowest rate per hour. The extremely high unemployment rates and the stress of the Depression that drove many to work at rates that were actually below subsistence levels exacerbated this situation.

The circumstances today are entirely different from those at the time the prevailing wage concept was first adopted. Construction laborers are now among the highest paid employees in America, far outstripping the average wage in manufacturing and most service industries. In October 2006, the average earnings of Minnesota construction workers was \$25.77 per hour while their manufacturing and retail trade counterparts were paid \$17.10 and \$13.34 per hour, respectively. Furthermore, state and federal minimum wage statutes have been passed, along with overtime protections, which provide a "floor" on wages for all classes of work, including construction labor. The shrinking of the labor market during the past two decades also has created a national construction labor shortage in most categories which has resulted in reasonable wage rates without the artificial constraints of the prevailing wage system.

Minnesota's prevailing wage statute states: "It is ... the policy of this state that wages of laborers, workers, and mechanics on projects financed in whole or part by state funds should be comparable to wages paid for similar work in the community as a whole." While this goal makes sense and seems to indicate that the market should be used to determine wage rates, the law is not implemented in that manner. The statute goes on to define the prevailing wage as the hourly rate of pay plus benefits paid to the "largest number of workers" engaged in the same classification of labor. Therefore, the Department of Labor must use a statistical calculation called the mode to determine prevailing wages.

This calculation contradicts the policy of the state because it can only result in higher wages than the market would pay. For example, if the prevailing wage rate is below or equal to the market rate, employers will pay the market rate. However, if the prevailing wage rate is above the market rate, employers are forced to increase wages. In addition, Minnesota and California are the only states to use this costly method of determining prevailing wage rates.

The following example shows how the mode calculation results in wages that do not represent the wages in a community. In 1995, the most common wage for unskilled labor in Rock County - and therefore the certified prevailing wage - was \$14.25 per hour. However, as the graph on the right shows, \$14.25 per hour does not reflect the wages paid for unskilled labor there. Six of the 10 hourly wages were significantly below \$14.25 per hour. The average wage was \$10.71 per hour and the median wage was \$8.92 per hour.



Nine states, including Kansas (the state that originated the concept), realized this during the 1980s and repealed their prevailing wage statutes. Nine other states, including Iowa, North Dakota and South Dakota, never enacted state prevailing wage laws.

Several studies have been conducted on the effect of prevailing wage laws on construction labor and project costs. The studies show significant cost savings if prevailing wage laws are repealed. The table below highlights the results.

| Effect of Repeal in: | Construction Savings | Labor Savings |
|----------------------|----------------------|---------------|
| Delaware             | 12%                  | 20%           |
| Florida              | 15%                  | 30-35%        |
| New York             | - - -                | 27%           |
| Pennsylvania         | - - -                | 30%           |
| West Virginia        | - - -                | 28%           |

Source: The Commonwealth Foundation for Public Policy Alternatives

The Minnesota Taxpayers Association (MTA) studied the prevailing wage for the Minnesota Associated Builders and Contractors. The MTA looked at 34 school construction projects, 57 state building projects and 247 state transportation projects. It concluded that, in 2002, Minnesota would have saved between \$126 million (7.4 percent of total project costs) and \$171 million (10.0 percent) if the state used the Department of Employment and Economic Development (DEED) median wage rates rather than the current state prevailing wage rates. It recommended that the DEED survey for median wages be used as an alternative definition of the prevailing wage and that DEED develop a survey to determine prevailing benefit rates.

**Wage mandates:** The issue of “livable wage” mandates grew out of the debates over welfare reform and the federal budget. Policy-makers at the state and federal levels have been arguing for greater accountability of dollars spent on welfare programs. In addition, savings from welfare reform have been a key component of federal deficit reduction plans from members of both parties. This heightened awareness of subsidy programs for individuals gave rise to the issue of accountability for business subsidies.

Even within the business community there is division over the use of business subsidies. Many believe that incentives merely treat symptoms of larger problems - high business taxes, for example. Instead of solving the problem, we create incentives that have cost and policy implications on all businesses, i.e., they increase spending/taxes to pay for programs and create new mandates that may eventually affect every company.

**State action:** In 1995, Minnesota adopted legislation requiring economic development agencies to establish wage and employment goals with businesses that receive \$25,000 or more of assistance (Minnesota Statutes 116J.991). In 1996, the omnibus economic development finance bill contained a provision establishing a “livable wage” for employers that receive grants or loans from the Minnesota Investment Fund. The wage rate equals 110 percent of the federal poverty guideline for a family of four (\$10.587 per hour for 2006); however, the federal guidelines are indexed so the wage rate will increase every spring when the U.S. Department of Health and Human Services updates the poverty thresholds.

In 1997, the Legislature created the Corporate Subsidy Reform Commission to examine subsidy programs for their public purpose, criteria for award and accountability and enforcement mechanisms. The commission recommended, among other things, that subsidy recipients pay 90 percent of their employees’ wages and benefits totaling at least 110 percent of the federal poverty guideline for a family of four.

In 1998, the omnibus tax bill contained a provision to require a manufacturing or distribution company located in a green acres tax-increment finance district to pay 90 percent of its employees’ wages and benefits at least equal to 160 percent of the federal minimum wage (currently \$8.24 per hour). This provision became law without any formal hearing in the House or Senate. It was inserted in the omnibus tax bill during conference committee again without much discussion on its impact.

In 1999, the Legislature strengthened the accountability and oversight provisions of Minnesota law by adopting several of the Corporate Subsidy Reform Commission’s recommendations. The adopted recommendations included the following: (1) business subsidies must meet a public purpose other than increasing tax base; (2) business subsidies may not be granted until the grantor has adopted criteria for awarding subsidies at a public hearing; (3) the criteria must include goals for the wages to be paid for the

jobs created. In addition, the granting agency and the business must enter into a subsidy agreement that among other things establishes the goals for wages and job creation and describes the recipient's financial obligation if the goals are not met.

The Minnesota Chamber opposes the 1998 Corporate Subsidy Reform Commission's recommendation to mandate that employers receiving "business subsidies" pay 90 percent of their employees' wages and benefits totaling at least 110 percent of the federal poverty guideline for a family of four. Our opposition is based on the following reasons:

- **Accountability law enacted.** In 1999 and 2000, the Legislature enacted several provisions designed to better hold businesses that receive subsidies accountable. They were based on many of the Corporate Subsidy Reform Commission's recommendations and should be given a chance to work.
- **Wages should not be set in statute or city ordinance.** The market can do a better job of determining wages than government agencies or the Legislature. A state-imposed minimum wage set in relation to the federal poverty guideline is an inflexible standard by which state and local economic development agencies must abide. It does not allow agencies to adapt to changing economic conditions, nor does it adjust for wage differences between regions of the state or industries. It also may drive up wages for neighboring, nonsubsidized businesses, distorting the local labor market.
- **The federal poverty guidelines are indexed.** By setting a minimum wage rate equal to a percentage of the federal poverty guideline for a family of four, the state is automatically increasing wages every year, in many cases without subsequent productivity gains.

Local action: The cities of Minneapolis and St. Paul adopted policies and the city of Duluth adopted an ordinance regarding the "livable wage." The Minneapolis and St. Paul policies, among other things, require businesses that receive \$100,000 of economic development assistance in a fiscal year to pay newly hired employees wages of at least 110 percent of the federal poverty guideline for a family of four. (St. Paul's policy allows employers to pay 100 percent of the guideline - \$9.62 per hour in 2006 - if basic health insurance is provided.) Small businesses, businesses in the first year of existence and intermediary organizations such as community development corporations are exempt from the policy. Economic development assistance includes land sales at less than a fair market price, loans, bonds, grants and city tax incentives.

The Minneapolis and St. Paul City Councils are considering adopting ordinances rather than relying on their existing policies. Both draft ordinances would establish a "livable wage" at 130 percent of the federal poverty guideline for a family of four for businesses that receive city subsidies or are awarded city contracts. Employees who receive health care benefits would have a lower mandated wage of 110 percent of the federal poverty guideline for a family of four. The St. Paul ordinance was put on hold and will likely be debated again in 2007.

The Duluth ordinance requires businesses that receive at least \$25,000 of economic development assistance to pay 90 percent of their workers \$7.25 per hour or \$6.50 per hour if health insurance benefits are provided. The wage levels are indexed to the rate of inflation. Economic development assistance is defined as enterprise zone credits, loans and grants, tax increment financing and lease abatements, among others.