

## Unhappy anniversary

### **Federal minimum wage remains unchanged for eighth straight year, falls to 56-year low relative to the average wage**

by Jared Bernstein and Isaac Shapiro (1)

September 1, 2005 marks an unhappy anniversary for minimum-wage workers. The federal minimum wage has remained at \$5.15 an hour since September 1, 1997. So for eight straight years the value of the minimum wage has eroded due to the effects of inflation, and the wage standard has fallen further behind the wages of other workers.

- The minimum wage now equals only 32 percent of the average wage for private sector, nonsupervisory workers. This is the lowest share since 1949.
- Over the past eight years, the purchasing power of the minimum wage has deteriorated by 17 percent. After adjusting for inflation, the value of the minimum wage is at its second lowest level since 1955.
- Since the inception of the minimum wage, there has been only one other period (from 1981 to 1990) in which the minimum wage has remained unchanged for more than eight years.

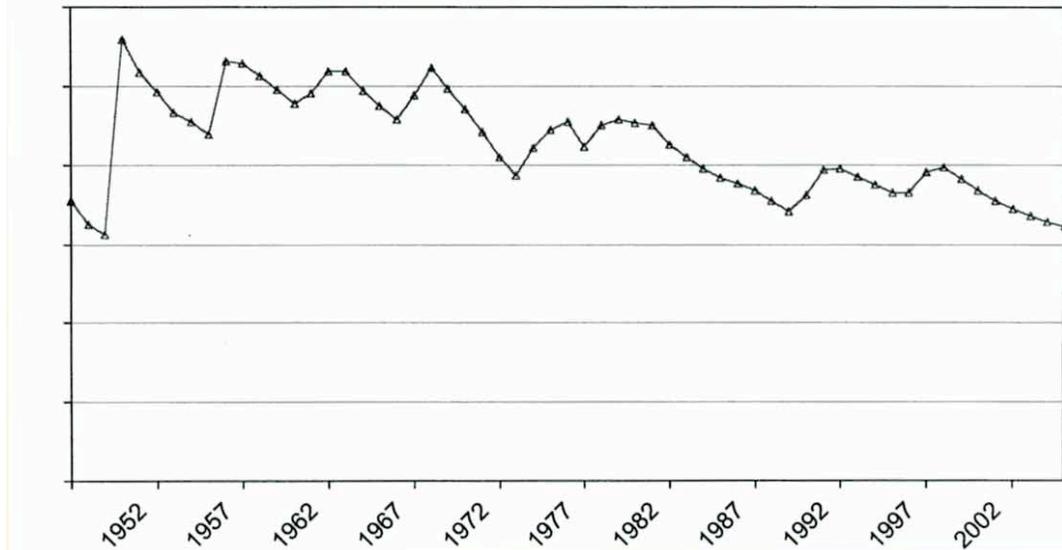
### **Relative to the average wage**

Since the federal minimum wage was first established in 1938, its level has often been set with the level of other workers in mind. This approach reflects the principle that minimum-wage workers should share in economic gains and should not fall too far behind other workers.

- During the 1950s and the 1960s, the minimum wage averaged 50 percent — or half — the average wage of workers in non-supervisory positions.
- As noted, the minimum wage has now fallen to 32 percent — or less than one-third — of the average wage of about \$16 for non-supervisory workers. This is the lowest share in more than five decades. (See Figure 1 and Table 1)

Figure 1

**Minimum Wage at 56-year Low Relative to Average Wage**  
(Minimum Wage Relative to the Average Private Nonsupervisory Wage, 1947-2005)



- Research has shown that the fall in the relative value of the minimum wage has contributed to the persistent increase in wage inequality since the latter 1970s.(2)

## Purchasing power

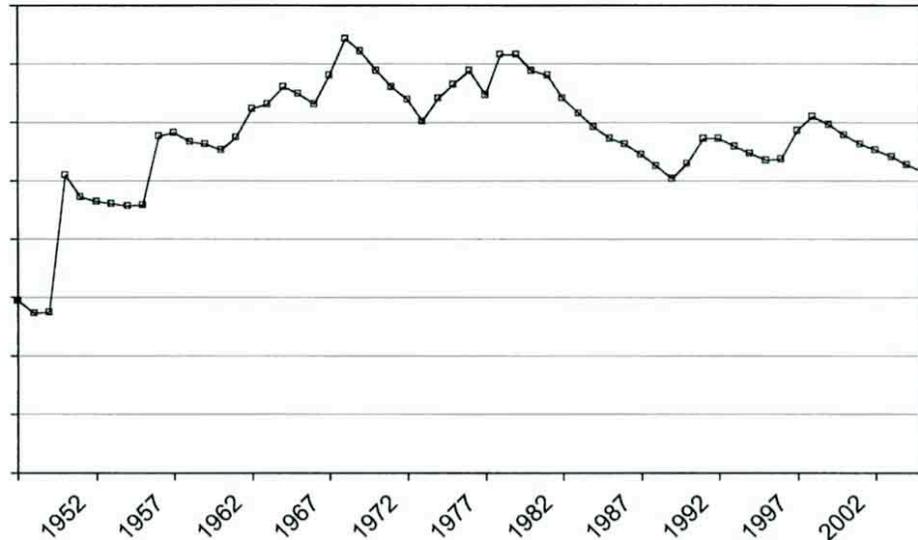
Another standard for assessing the value of the minimum wage is to track its buying power; that is, to adjust its value to take into account changes in the cost of living. Since the minimum wage is set at a given level and not adjusted for inflation, each year that Congress fails to raise the wage floor its purchasing power erodes. Thus, the fact that the minimum wage has remained the same for eight years means that its real value has declined considerably over this period.

- The real value of the minimum wage peaked in 1968, when it was equivalent to a wage of \$7.54 an hour (3). During the 1970s, the wage floor averaged \$6.71 an hour in today's dollars. (See Figure 2 and Table 1)

Figure 2

### Minimum Wage Purchasing Power Low by Historical Standards

(The Inflation-Adjusted Value of the Minimum Wage, 1947-2005)



- Once an adjustment for inflation is taken into account, the purchasing power of the minimum wage has now declined to its lowest level since 1955, with the exception of 1989.

### Other periods of decline were followed by significant increases in the wage standard

It is worth noting that after the minimum wage fell to an exceptionally low level in 1989, early the next year Congress adopted, with the support of then-President George H. W. Bush, an increase in the minimum wage of 27 percent over a two-year period. After the minimum wage last equaled less than a third of the average private nonsupervisory wage (in 1949), the minimum wage was increased by 75 percent.

This Congress and the Administration have failed to act on the issue. This has been so despite the strong drop in the value of the minimum wage, as well as the unevenness of the current economic recovery. A variety of data, government officials (including Treasury Secretary John Snow) (4), and stories all confirm that those at the bottom of the economic spectrum are not faring well during this recovery and that the gains from the recovery have been concentrated at the top. For instance, a recent front-page story in *The Washington Times* said, "The revival [in income growth] is mainly among top earners who receive stocks, bonuses and other income in addition to wages." (5) The *Times* story drew heavily on July congressional testimony by Federal Reserve Chair Alan Greenspan, during which he also noted the growth in income and wage disparities. (6)

By itself, of course, increasing the minimum wage would not fully correct the imbalances in the current recovery. It would, however, help address them by lifting the buying power of the lowest paid workers and closing some of the distance between the earnings of minimum-wage workers and that of the average worker. After eight years, it remains to be seen whether Congress and the Administration will address the long period of real and relative declines in the minimum wage.

**Many thanks to Jared Bernstein at the Economic Policy Institute and to Isaac Shapiro at the Center for Budget and Policy Priorities. You can get more information on this and many other topics at their websites, [www.epi.org](http://www.epi.org) and [www.cbpp.org](http://www.cbpp.org).**

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- (1) .. Jared Bernstein is director of the Living Standards program at the Economic Policy Institute. Isaac Shapiro is an associate director at the Center on Budget and Policy Priorities.
- (2) .. See, for example, David Lee, *Inequality in the United States During the 1980s: Rising Dispersion or Falling Minimum Wage?* *Quarterly Journal of Economics*, 1999, 114(3), 977-1023.
- (3) .. We adjust for inflation using the CPI-RS (research series). The “RS” is a historically consistent series used by many analysts, including the U.S. Bureau of the Census, to adjust for price changes. Relative to the more commonly used CPI-U, the CPI-RS grows more slowly, meaning that the real minimum wage deflated by the CPI-U has a higher peak level: \$8.88 in 1968 in today’s dollars.
- (4) .. Jonathan Weisman, “Snow Concedes Economic Surge Is Not Benefiting People Equally,” *The Washington Post*, August 9, 2003, page A3.
- (5) .. Patrice Hill, “Income gap grows in U.S.,” *The Washington Times*, July 31, 2005, page A1.
- (6) .. Alan Greenspan, chair of the Federal Reserve Board, Testimony before the House Financial Services Committee, Question and Answer period, July 30, 2005.

# Many States Face Structural Budget Problems

## New report outlines policies to prevent chronic budget gap

Many states risk chronic gaps between revenues and necessary expenditures in coming years because of structural weaknesses in their tax systems, according to a new report by the Center on Budget and Policy. These weaknesses are largely independent of the cyclical budget problems caused by economic downturns. Thus, even though states are now enjoying expanded revenues due to the economic recovery, they could face serious budget problems in coming years if their structural issues are not addressed.

“After we came out of the 1990s recession, states generally lost interest in fixing their structural problems because the bubble revenues of the late 1990s masked the problems — but the problems now have reemerged,” said Liz McNichol, senior fellow at the center and co-author of the report. “With the fiscal crisis easing in most states, states can take the initiative to modernize and strengthen their revenue systems.”

The new report, *Faulty Foundations: State Structural Budget Problems and How to Fix Them*, is the first to provide state-by-state measures of the policies that put a state at risk of a structural deficit. It includes fact sheets with the findings for each state.

The report finds that the states most at risk of structural deficits are Alaska, Arkansas, Colorado, Florida, Nevada, New Mexico, Pennsylvania, South Carolina, Tennessee, Texas and Wyoming. These states scored nine or higher on the structural deficit risk scale developed in the report. More than half of the states scored seven or higher, and no state had fewer than three risk factors.

## Obsolete revenue systems in many states

A prime cause of structural deficits is that most states have failed to respond to the economy’s shift from goods to services, which make up a growing share of all economic activity. That shift has cut into state sales tax revenues, since most states do not tax services. The rapid growth in Internet purchases is also hurting sales tax revenues, since states generally cannot collect taxes on these purchases.

State income taxes have weakened in recent decades as well. Corporate income tax revenues have shrunk by nearly half as a share of total state revenues over the past two decades, as a result of obsolete state corporate tax policies and corporations’ increasingly aggressive tax-avoidance schemes.

Many states’ personal income tax systems have become “flatter” as a growing share of taxpayers have moved into the top tax bracket (usually because the state failed to update its brackets to reflect rising incomes). In 18 states plus the District of Columbia, households with taxable income of \$30,000 are in the same bracket as those with taxable income of \$300,000. In addition, the extra tax breaks many states give to the elderly — regardless of income — are becoming increasingly costly as the population ages.

Other important causes of state structural deficits include federal restrictions on state taxing authority (such as the federal ban on state taxation of Internet access fees) and state budget requirements that limit revenues (such as tax and expenditure limits).

## Comparing states’ risk of structural deficits

The table below compares the risk factors for future structural deficits between all 50 states.

|         |   |   |   |   |        |
|---------|---|---|---|---|--------|
| 10 or 9 | 8 | 7 | 6 | 5 | 4 or 3 |
|---------|---|---|---|---|--------|

|                     |              |                 |                |           |                      |
|---------------------|--------------|-----------------|----------------|-----------|----------------------|
| Alaska              | Alabama      | Arizona         | Connecticut    | Kansas    | Minnesota            |
| Arkansas            | Georgia      | California      | Delaware       | Louisiana | Nebraska             |
| Colorado            | Kentucky     | Hawaii          | Illinois       | Maine     | New Jersey           |
| Florida             | Missouri     | Idaho           | Iowa           | Maryland  | North Dakota         |
| Nevada              | Rhode Island | Indiana         | Massachusetts  | New York  | Vermont              |
| New Mexico          | South Dakota | Michigan        | Montana        |           | Wisconsin            |
| Pennsylvania        | Washington   | Mississippi     | New Hampshire  |           |                      |
| South Carolina      |              | Oklahoma        | North Carolina |           |                      |
| Tennessee           |              | <b>Virginia</b> | Ohio           |           |                      |
| Texas               |              |                 | Oregon         |           |                      |
| Wyoming             |              |                 | Utah           |           |                      |
|                     |              |                 | West Virginia  |           |                      |
| <b>Most at Risk</b> |              |                 |                |           | <b>Least at Risk</b> |

## Inadequate funds to maintain current services

In states with structural deficits, revenues do not grow at the same rate as the cost of government. As a result, these states are unable to continue providing their current level of services, let alone respond to voters' demands for new investments in education and other areas.

Structural deficits have received little public attention to date, largely because states have adopted various ad-hoc measures to mask them. For example, many states, including Virginia, raised sales taxes: the average sales tax rate rose by about 50 percent between 1970 and 2003. Sales tax revenues, on the other hand, rose by only 20 percent during this period because of the shrinkage of the sales tax base. Raising tax rates is not a permanent substitute for fixing underlying problems because it places unfair burdens on a narrow segment of the population and undermines public confidence in government.

## Some states strengthening their fiscal foundation

The report evaluates each state's susceptibility to structural deficits by determining how many risk factors apply to the state. The report considers ten risk factors, including the extent to which the state taxes services, the strength of the corporate income tax, the progressivity of the personal income tax, and the presence of revenue barriers such as tax and spending limits.

The report also outlines policy responses to each of these risk factors, some of which have already been adopted by certain states:

- Georgia, Maryland, New York, and Vermont were the most recent of 23 states to strengthen their corporate income taxes by closing the "passive investment company" loophole, which allows corporations to avoid state taxes by shifting income into "tax haven" states.
- Virginia, which used to exempt all pension income from its income tax, recently phased out that exemption for higher-income people.
- Forty of the 45 states with a sales tax have embarked on a project to simplify their sales tax in order to encourage Congress to pass legislation allowing states to require mail-order and Internet vendors to collect sales taxes.
- Nebraska has expanded its sales tax base to include a number of services.

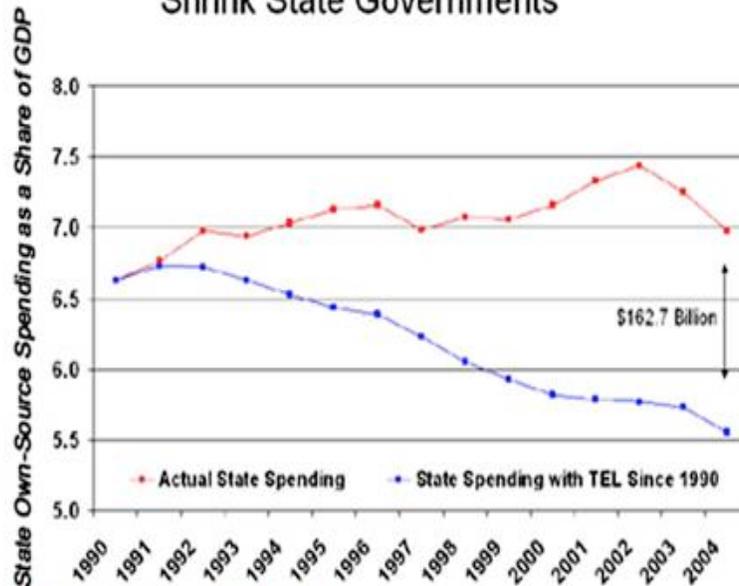
"States are playing a greater role than ever before in providing public safety, health care, and education," said Iris Lav, deputy director of the Center and co-author of the report. "Modernizing their fiscal systems by identifying and fixing structural problems will prepare them to shoulder these responsibilities."

## State spending limits: threats to social services

*This year in the Virginia General Assembly, a number of constitutional amendments passed the House only to be killed in the Senate (HJ525, HJ549, HJ606, HJ622, HJ653, SJ408.) These bills would have put an artificial cap on the size of the state budget, and were modeled on other amendments that have been put in place in other states, including Colorado, with disastrous results. This article from the Center on Budget and Policy Priorities gives the details.*

State spending limits are constitutional amendments that limit the growth of state and local revenues to a highly restrictive formula, the rate of growth of population plus inflation. Allowing revenue to grow with population and inflation may sound reasonable, but it falls far short of being able to fund the ongoing cost of government. In an era in which health care costs are growing far faster than inflation and populations are aging, limiting the rate of spending growth to inflation plus population growth forces annual reductions in the level of government services.

### Population-Plus-Inflation Growth Formula Would Shrink State Governments



Source: CBPP calculation of NASBO data

Note: "Own-Source" spending is the sum of general fund and other state spending.

If a population-plus-inflation spending limit had been in effect for total state spending since 1990, state spending in 2004 would have been \$631 billion rather than the actual figure of \$793.7 billion.

Most spending limit proposals under consideration include a feature that periodically sharply lowers — or ratchets down — the permissible level of government services. The permissible level of revenues is set relative to the previous year's revenues. Thus when there is a recession and revenue collections drop, those depressed revenues become the new base for the application of the inflation plus population growth formula. This means that public services in a state with a spending limit never can recover from an economic downturn.

Some spending limit proposals also require voter approval for all tax increases. This feature puts the fate of tax changes in the hands of whoever can afford the high cost of placing a measure on the ballot and

supporting it with advertisements. And it allows those who can muster the resources to conduct all-out campaigns against reasonable changes that may be needed.

Indeed, there is no better way to shrink the scope of what government can accomplish; state spending limits create conditions that each year pit programs and services against each other for survival. And once such limits are embedded in a state constitution, they are virtually impossible to remove or even modify. They undermine existing services for children, youth, and families and make any new initiatives virtually impossible to undertake.

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