

# Bloomberg

## Minimum Wage Increase in U.S. Will Probably Promote Spending

By Jeanna Smialek - Feb 27, 2014

As the debate rages on whether an increase in the U.S. [minimum wage](#) will boost or hinder hiring, one aspect is more unambiguous. It would almost surely lift [consumer spending](#).

While the effect will probably be positive, the magnitude of the improvement remains up in the air. A pay hike of \$1.75 an hour, smaller than currently proposed, would augment purchases by at least \$48 billion in the first year, according to a 2013 paper by [Federal Reserve Bank of Chicago](#) economists. Analysis by private researchers points to a smaller gain.

A raise would help lower-income earners contend with a decrease in government assistance such as the food-stamp program and the increase in the [payroll tax](#) that have hurt household purchases, which account for almost 70 percent of the economy. The [Congressional Budget Office](#) estimates there are about 16.5 million Americans who make less than \$10.10 an hour, the new minimum being [proposed](#) by the Obama administration.

“Pretty much every penny of the extra wages these minimum-wage workers get they’ll be spending,” said [Joshua Shapiro](#), chief U.S. economist at Maria Fiorini Ramirez Inc. in [New York](#). “I doubt they have any scope for saving. They’re barely getting by.”

Richard Wilson, 27, says a higher minimum means he would have to make fewer tough choices when deciding how to best spend the \$9.25 that he now makes per hour as a meat department worker at a Wal-Mart Stores Inc. outlet in [Chicago](#).

“I have to choose sometimes between a monthly bus pass, a weekly bus pass, lunch for the day,” said Wilson.

### Wal-Mart

Wal-Mart, the largest private employer in the U.S., is weighing the impact of additional payroll costs against possibly attracting more consumer dollars to its stores, [David Tovar](#), a company spokesman, said last week. Increasing the minimum wage means that some of the 140 million people who shop at the chain weekly could “now have additional income,” Tovar said.

A \$1 increase in minimum pay leads to \$250 in extra income per quarter for households with adult minimum-wage earners, spurring \$700 in quarterly spending in the year following the

escalation, Federal Reserve Bank of Chicago researchers [found](#) in 2011. That's because households can make down-payments and borrow more as incomes climb, which enables them to boost spending, according to their analysis using data from the 1980s to 2008. The period included six increases in the federal minimum.

## Fed Study

“We actually have a very large consumption effect,” said Sumit Agarwal, one of the authors of the study who is now at the [National University of Singapore](#). A 2013 [update](#) by the Chicago Fed showed that a hike to \$9 from the current \$7.25 would boost gross domestic product by 0.3 percentage point, or \$48 billion, in the first year, though it would have little effect in the long run.

“If you go to \$10.10, versus \$9, even that one dollar increase will definitely boost up the economy, and GDP, as you have purchases and consumption,” said Agarwal, an economics professor. As for the increase, “if you say it's going to be \$2, it's not going to be linear, which means it's not going to double the effect.”

As workers go higher on a pay scale, the more they'll spend on durable goods, primarily cars, Agarwal said. Past increases also boosted credit-card spending by \$300 to \$400 over the first couple of years, he said. “They will go out and maybe eat better food or buy better groceries.”

## Buying Power

That will help make up for a small portion of the loss in buying power elsewhere. A new farm law cuts \$8.6 billion from [food stamps](#) over the next decade. About 850,000 households will see their food support cut by about \$90 a month. Also, in 2013 the payroll tax used to fund programs such as [Social Security](#) reverted to 6.2 percent, where it had been prior to the recession, from 4.2 percent.

While other analysts agree the impact of minimum-wage increase will be positive, they say the boost will be smaller than projected by the Chicago Fed researchers.

A hike to \$10.10 could add \$22.1 billion to GDP, almost entirely from gains in consumer spending, based on [estimates](#) from the [Economic Policy Institute](#), a Washington-based research group partly funded by labor unions. U.S. workers would gain \$35 billion in wages over the phase-in period through 2016, by EPI's estimate.

The study didn't attempt to take into account how much more borrowing would be stimulated by the increase, said report author David Cooper, which may be one reason why its estimate is lower than the Chicago Fed's projection.

## Income Growth

“If the additional demand it creates compels businesses to invest a little more in their productive capabilities, to take on some new workers to meet increased demand, well than that’s just going to spur more income being paid out,” Cooper said.

The EPI estimate is still higher than what [Mark Zandi](#), chief economist at Moody’s Analytics Inc. projects. He sees a boost in growth just shy of \$10 billion by 2016. For context, the expiration of the emergency unemployment insurance program alone will cut spending this year by \$20 billion to \$25 billion, he said.

Zandi’s model assumes employment and growth will pick up during the rollout, unlike EPI’s, which Zandi and Cooper said could give rise to the discrepancy. Consumers tend to spend less at each level of income during better economic times, they said.

Zandi also said he thinks credit effects would be small. “Households are very credit constrained, and in the current environment, more than they were in times past,” he said. That means that borrowing is unlikely to pick up.

## Paying Bills

Wilson is a prime example. He would use a raise to pay down a \$60,000 loan he took out to attend Liberty University in Lynchburg, Virginia. Wilson said he began to default on his loans without a diploma to his name.

“I’m in the process of paying off my school so that I can get my degree and get a better job,” said Wilson, a member of union-backed employee group OUR Wal-Mart.

Because lower wage-earners have a higher propensity to spend than higher-income groups, a Congressional Budget Office [analysis](#) predicts a net positive spending effect arising from the \$10.10 hike even as 500,000 workers lose their jobs, prices increase and costs to business rise.

Chris Edwards, director of tax policy studies at the Washington-based [Cato Institute](#), which advocates for smaller government, said the end result for spending and the economy may be negative.

## Supply Side

Government-created “distortions undermine GDP, income and overall consumption in the economy by damaging the supply side of the economy,” Edwards said. “There is no free lunch, you don’t get something for nothing. There would be layoffs, they’re going to pay other employees less. You’re making business production in the U.S. a little bit less efficient, which means less will be produced.”

The response to a federal wage hike matters for companies such as Wal-Mart, Wilson's employer.

The Bentonville, Arkansas-based company, the world's largest retailer, forecast profit this year that trailed analysts' estimates as slow economic growth and government benefit cuts threaten to limit sales.

"Low-income workers have a higher propensity to consume than the wealthy, because the latter are not nearly as income-constrained," said [Jared Bernstein](#), a senior fellow at the Washington-based Center on Budget and Policy Priorities and former chief economic advisor for Vice President [Joe Biden](#). "It's basic common sense backed by economic logic."

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