CALIFORNIA BUDGET PROJECT

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INDEXING THE MINIMUM WAGE TO INFLATION

Inflation has eroded the purchasing power of California's minimum wage since it was last increased in 2002. Some minimum wage proponents advocate "indexing" the minimum wage to inflation – automatically adjusting the minimum wage to keep pace with the cost of living. The following provides an overview of what indexing would mean for California's minimum wage and how it would work.

KEY FACTS

- **What is indexing?**

Indexing the minimum wage to inflation would automatically adjust the minimum wage each year to keep pace with changes in the cost of living. This would ensure that the purchasing power of the minimum wage remains the same over time.

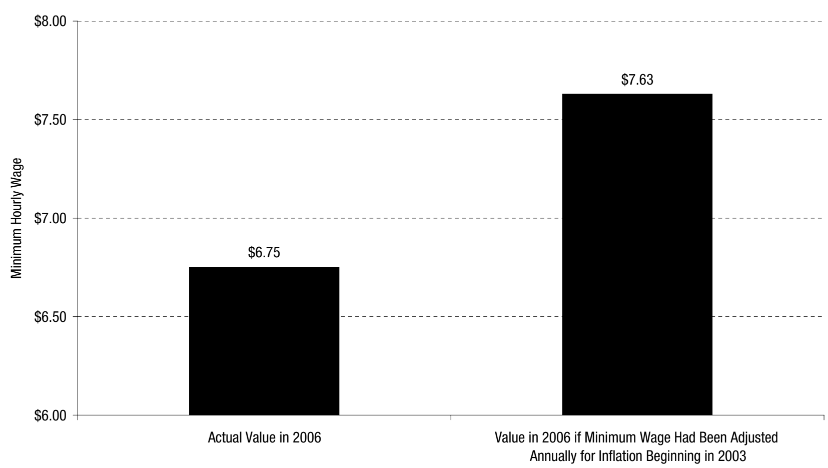
- **How does indexing work?**

Indexing would adjust the minimum wage by the same percentage that inflation changes each year. For example, if inflation increased by 2 percent, then the minimum wage would rise by 2 percent. One common measure of inflation is the Consumer Price Index for All Urban Consumers (CPI-U). The CPI-U measures the average change over time in the prices paid by urban consumers for commonly purchased goods and services.

- **What would the minimum wage be today if it had been indexed to inflation?**

The state's minimum wage currently would be $7.63 per hour – $0.88 above its actual level – if it had been adjusted annually beginning one year after its last increase in 2002.

California's Minimum Wage Would Be $7.63 Per Hour if It Had Been Indexed to Inflation Beginning in 2003



Note: Inflation adjustment is the California Consumer Price Index for All Urban Consumers (CPI-U).
Source: CBP analysis of Department of Finance data

- **How much would indexing affect the minimum wage each year?**

Indexing likely would result in modest annual changes to the minimum wage. Prices in California have increased by an average of 3.1 percent per year since 2002. A 3.1 percent increase would raise the current minimum wage of $6.75 by 21 cents per hour.

- **Would indexing affect employment?**

While conventional wisdom holds that minimum wage increases reduce employment, empirical evidence suggests otherwise. In fact, in the 1999 Economic Report of the President, the Council of Economic Advisors wrote, "...the weight of the evidence suggests that modest increases in the minimum wage have had very little or no effect on employment." Since indexing likely would result in modest increases to the state's minimum wage, employment effects almost certainly would be minimal.

- **What is the effect of not indexing?**

When the minimum wage is not indexed to inflation, it loses purchasing power as the cost of basic necessities increases. The purchasing power of the state's minimum wage is 11.5 percent lower today than it was four years ago when the minimum wage was last increased, and one-third (33.1 percent) lower than it was at its high point in 1968.

- **Which states index the minimum wage to inflation?**

Florida, Oregon, and Washington annually adjust their states' minimum wage based on changes in inflation. Vermont will begin indexing its minimum wage to inflation in 2007.

Alissa Anderson Garcia prepared this Policy Points. Support for this Policy Points was provided by the Rosenberg Foundation. The California Budget Project (CBP) was founded in 1994 to provide Californians with a source of timely, objective, and accessible expertise on state fiscal and economic policy issues. The CBP engages in independent fiscal and policy analysis and public education with the goal of improving public policies affecting the economic and social well-being of low- and middle-income Californians. General operating support for the CBP is provided by foundation grants, individual donations, and subscriptions. Please visit the CBP's website at www.cbp.org.