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The Effects of the Minimum Wage Increase on the Restaurant Industry

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In January 1999, Oregon's minimum wage rose to $6.50, making it the highest in the country.[1] This was the result of a 1996 voter initiative which gradually increased Oregon's minimum wage from $4.75 to $6.50.[2] The voter-enacted increase was extended to all workers covered by the minimum wage law. The Oregon Legislative Assembly, however, is currently considering legislation that would allow employers to pay some tipped workers and young employees less than the minimum wage.[3] Claiming that the industry has experienced hardship as a result of Oregon's increased minimum wage, the Oregon Restaurant Association (ORA) is the chief proponent of the legislation.

This report examines the impacts that recent increases in the minimum wage have had on the restaurant industry and, when more specific data are not available, the retail trade industry. The restaurant industry comprises 37 percent of retail trade employment. This focus on retail trade and restaurants is warranted for two reasons. First, the attempt to repeal provisions of the existing minimum wage law is centered on tipped workers in restaurants and bars. Second, because of the high concentration of minimum wage workers in restaurants and retail trade, any potentially negative effects of increasing the minimum wage will be found here.

This paper demonstrates that the restaurant industry and retail trade sectors of Oregon have continued to perform well under the 1997 and 1998 minimum wage increases. The data reveal that employment has expanded and is projected to increase in the future, average hours worked by employees have risen, establishment openings outpace closures, sales are expected to increase, inflation has fallen, and employee real earnings have gone up.

[1] As a result of a recent ballot initiative, Washington's minimum wage will increase to $6.50 in 2000 and will rise each year with the Consumer Price Index.

[2] The 1996 initiative raised the minimum wage in three stages: from $4.75 to $5.50 on January 1, 1997, to $6.00 on January 1, 1998, and to $6.50 on January 1, 1999.

[3] House Bill 2793 allows employers to pay tipped workers $5.50 per hour if the employee earns $4.50 or more per hour in tips. The proposed legislation also creates a $5.50 per hour training wage for the first 60 days of employment for workers under 18.

Measuring the Impact of the Minimum Wage Increases

There is a range of opinions regarding the impacts of minimum wage increases. Some maintain that the wage increases cause employment to decline and businesses to fail as owners respond to rising labor costs. In addition, some warn that the wage increase may result in rising prices and reduced working hours, harming the low-wage workers the increase is designed to help. Alternatively, others insist that an increase in the minimum wage is an effective way to help the working poor, has minimal negative employment effects, and will not cause significant harm to businesses.

The precise impacts of increasing the minimum wage are not easy to predict. According to economists at the Oregon Employment Department, the effects of an increase in the minimum wage will depend on many factors, including the size of the increase, the time period allowed for the increase to take place, labor and product market conditions, and labor shortages or surpluses. Other factors include the unemployment rate, the prevailing market wage levels for entry-level workers, the skills and productivity of affected workers, the rate of inflation and the ability of employers to absorb, offset, or pass on their higher labor costs.

Given the many factors involved, predicting the effects of Oregon's 1999 minimum wage increase is difficult at best. However, looking at industries with a large number of minimum wage workers can reveal the effects of recent changes. Data covering employment, earnings, hours, prices, and other trends that indicate basic issues of business and economic health are available covering the periods after the 1997 and 1998 increases. Impacts of the 1997 and 1998 increases, which were both larger than the 1999 increase, can help us know what to expect from the 1999 increase and others in the future.[4]

Data versus Opinions about the Minimum Wage

In contrast to data recording what actually happened, there are also surveys that investigate opinions about the impacts of the minimum wage increases. A recent study commissioned by the Oregon Restaurant Association (ORA) explores the thoughts that restaurant operators and owners have about the impacts of Oregon's minimum wage increases.[5] In this survey, restaurant owners and operators were asked how they have responded to recent increases and how they plan to respond in the future.

Despite a number of serious methodological errors, the ORA survey nevertheless distills the opinions of many people opposed to the minimum wage.[6] These opinions can be contrasted with

[4] The first increase was the largest, nearly 16 percent, the second was a 9 percent increase, and the third was an 8 percent increase.

[5] Terborg, James R., The *Impact of Increases in the State Minimum Wage on the Oregon Restaurant Industry: 1997 to 1999, 2/22/99.*

[6] Major problems with the ORA study were pointed out in the March 12, 1999 testimony on HB 2793 by Dr. Stephen M. Johnson of the Oregon Survey Research Laboratory and Dr. Gordon Lafer of the University of Oregon Labor Education and Research Center before the House Business and Consumer Affairs Committee. Among their concerns, Drs. Johnson and Lafer suggest that the study cannot be considered representative of the restaurant industry because the response rate was less than half of what is required for [continued on next page]

the actual data to test the merits of their recollections of past actions and predictions for the future. As this paper will show, the respondents' perceptions about what happened after the 1997 and 1998 minimum wage increases do not always match the economic data.

The Impacts on Employment

One major concern about increasing the minimum wage is that it might result in a loss of jobs for the low-wage workers intended to receive the increase, leaving them worse off. This is the result anticipated by many of the restaurant owners in the ORA poll. Sixty-two percent of restaurant operators surveyed claimed that they reduced the number of employees in their establishment after the 1998 minimum wage increase.[7]

The data suggest otherwise: employment did not decline following the minimum wage increase. An analysis of the minimum wage increases by the Oregon Employment Department concluded that "The first two minimum wage increases appear to have little or no adverse employment effect on the state's economy, and may have boosted the incomes of many low wage workers."[8]

In contrast to the ORA poll, other industry surveys indicate that the minimum wage increases have had little negative effect on small businesses. The National Federation of Independent Businesses of Oregon (NFIB) released a survey in March, 1998, showing that 54 percent of NFIB members were already paying starting wages of $6.50 or more, 50 cents above the minimum wage at the time of the survey.[9] According to the NFIB survey, a minority of businesses had to raise prices (26 percent), lay off workers (13 percent), and/or cut benefits (5 percent) as a result of the first two increases in the minimum wage.

Retail Trade Employment

Retail trade is the industry most affected by minimum wage increases, with retail establishments employing half of all minimum wage workers. Nonetheless, average annual employment in retail trade rose from 276,600 in 1996, before the first minimum wage hike, to 287,600 in 1998, nearly a 4 percent increase. Retail employment expanded in both of the post-increase years. The Oregon Employment Department has credited the retail and service industries with the bulk of the state's nonfarm payroll employment increases in 1998.[10]

[continued from previous page] representative mail surveys, and no attempt was made to determine if the response was biased in favor of ORA membership. In addition, instead of using employment records to determine or verify events, the survey relies solely on operators' recollection of past behavior.

[7] Terborg, pg. 7.

[8] Oregon Employment Department, *Labor Trends*, December 1998.

[9] Oregon NFIB press release dated March 19, 1998.

[10] Oregon Employment Department News release, February 25, 1999. "Statewide nonfarm payroll employment increased by 2.0 percent, a gain of 30,200 jobs. Most of the gains came from retail and service industries."

Restaurant Industry Employment

Eating and drinking establishments account for 37 percent of all retail employment and are largely responsible for “the fate of retail trade in any given year."[11] Restaurants are also the sector of retail trade that is most affected by the minimum wage increase, with about 30 percent of workers receiving the minimum wage.[12] Despite this, the restaurant industry has grown in each of the years the minimum wage increased *(Table 1).* In 1996 Oregon eating and drinking establishments employed 102,500 workers, and, by 1998, employment had increased to 104,400.

Table 1. Oregon Employment by Industry

	1996	I997	1998
Eating & Drinking Establishments	102,500	103,900	104,400
Retail Trade	276,600	283,700	287,600
Nonfarm Employment	1,474,600	1,526,400	1,561,600

Source: Oregon Employment Department

While employment growth in eating and drinking establishments continued under the first two increases of the minimum wage, the rate of growth seen in 1997 and 1998 was not as strong as in previous years. Restaurant employment grew just under 4 percent in 1996, but it expanded by less than 1 percent in 1998. The slow-down, however, was not limited to eating and drinking establishments or to the retail trade industry. Growth in employmnent slowed for the state’s entire economy. Total nonfarm employment grew only 2 percent in 1998, after expanding nearly 4 percent in 1996. Oregon’s slowdown in employment growth is commonly attributed to the impact of the Asian financial crisis on the Oregon economy.

Future Growth for Restaurant Employment Expected

The long term growth prospects look bright, and the Oregon Employment Department projects that from 1996 to 2006 employment will expand for waiters and waitresses (27 percent), food preparation workers (32 percent), and restaurant cooks (35 percent). These occupations’ projected growth is so strong that the Employment Department, in the 1998 Oregon *Economic Profile,* concluded:

> Together, waiters and waitresses, food preparation workers, and restaurant cooks will provide over one quarter of all new jobs [from 1996 to 2006] in the services field. At the rate the restaurant industry has grown and is projected to grow, one might almost expect the demise of the family dining room![13]

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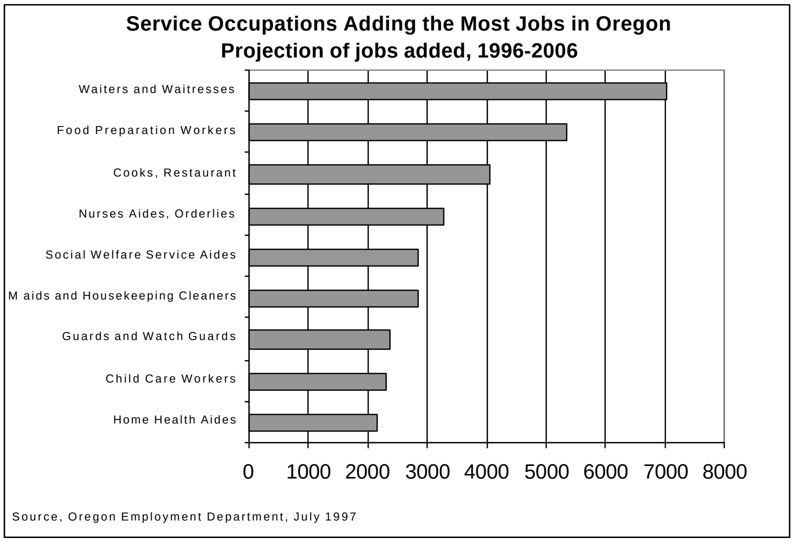
[11] Oregon Employment Department 1998 Oregon *Economic Profile,* pg. *34.* December 1997.

[12] Oregon Employment Department, *Labor Trends*, December 1998.

[13] Oregon Employment Department, *Oregon Economic Profile,* pg. *52.* December 1997.

The Oregon Employment Department projects employment in Oregon's eating and drinking industry to increase 22.6 percent between 1996 and 2006, outpacing the growth of the economy as a whole.[14]

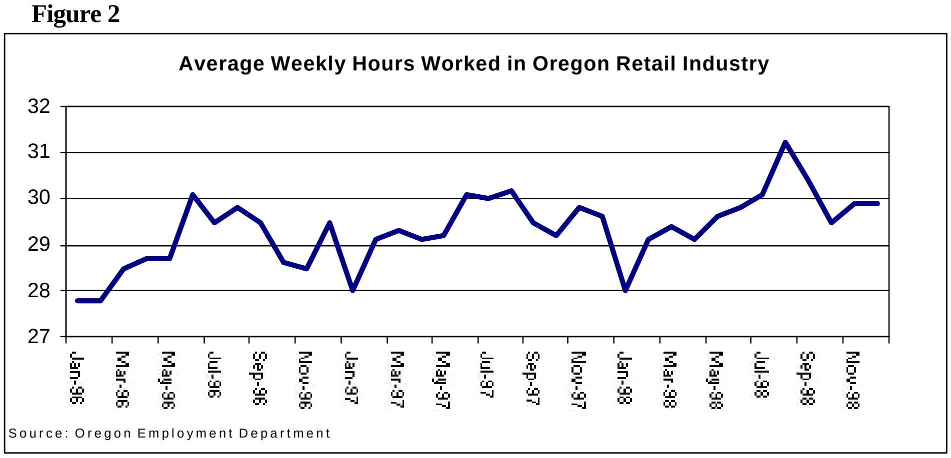
Figure 1



The Impact on Hours

Some fear that in addition to or instead of firing workers, establishments employing low-wage workers respond to minimum wage increases by cutting back on employees' hours. Supporting this suspicion, 62 percent of restaurant operators surveyed by the ORA claimed they had cut back employees' hours in response to the 1998 increase.

Figure 2



[14] The Oregon Employment Department's 1996-2006 projection for nonfarm payroll growth is 21 percent.

If reductions in hours are occurring, however, they are certainly not representative of the retail industry as a whole. As Figure 2 reflects, the average weekly hours worked by workers in retail have ***increased*** since 1996. In 1996, retail industry workers worked an average of 28.9 hours per week. By 1998, average hours had risen slightly to 29.8.

The Impact on Business Health

Will the increases in the minimum wage force existing businesses to close and dissuade other businesses from locating in the state? Ninety-four percent of restaurateurs responding to the ORA survey claimed that the 1998 increase had a negative impact on their business.[15] In addition, 77 percent opined that recent minimum wage increases were a major contributor to business failures and 75 percent predicted that other firms will decide not to locate in Oregon largely as a result of the increases.[16]

Data on Oregon restaurant openings and closings specifically are not readily available. However, Oregon's national ranking on total new business openings has improved since the minimum wage increases. In 1996, there were 7 other states that had relatively more new companies.[17] By 1998, there were only 6 that had more new companies than Oregon.

Business closures in Oregon were also at a very low level in 1998. Only twelve other states had fewer business closures than Oregon that year. The 1998 ranking is an improvement over the state's 1996 position when 27 other states had fewer business closings. In 1997, on the other hand, Oregon had one of the highest levels of business closures in the country.

Dun and Bradstreet data on Oregon business failures, however, show that higher number of closures cannot be explained simply as a result of 1997's minimum wage increase.[18] The percentage decline in net new business openings (starts minus failures) was nearly identical in retail trade and in the economy as a whole. Net retail trade starts were down 50 percent in 1997 and net starts for all private domestic businesses were down 47 percent. If the growth in business failures in 1997 were due to the minimum wage increase, retail trade failure would be a higher percent of total failures. This did not occur. Retail trade employment constituted 19 percent of Oregon's total employment and 19 percent of total business failures in 1997. Retail trade's share of business failures actually declined slightly, going from 21 percent of failures in 1996 to 19 percent in 1997. This suggests that the minimum wage increase in 1997 was not a strong factor influencing retail business failures in 1997.

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[15] Terborg, pg. 6. Although the actual survey asks whether there was an "impact," apparently it is meant to be interpreted as meaning a "negative impact."

[16] Terborg, pg. 7.

[17] Oregon Progress Board, 1999 *Benchmark Performance Report,* pg. *74. The* rankings are relative comparisons among the states. A larger state, such as California, may have a larger number of new business openings, but Oregon could have a higher ranking based upon the size of its economy.

[18] Dun and Bradstreet *Business Starts Record* and *Business Failure Record* for 1996 and 1997. The Dun and Bradstreet start and failure data rely on court records, while the Progress Board's business opening and closing information is based on unemployment insurance tax records.

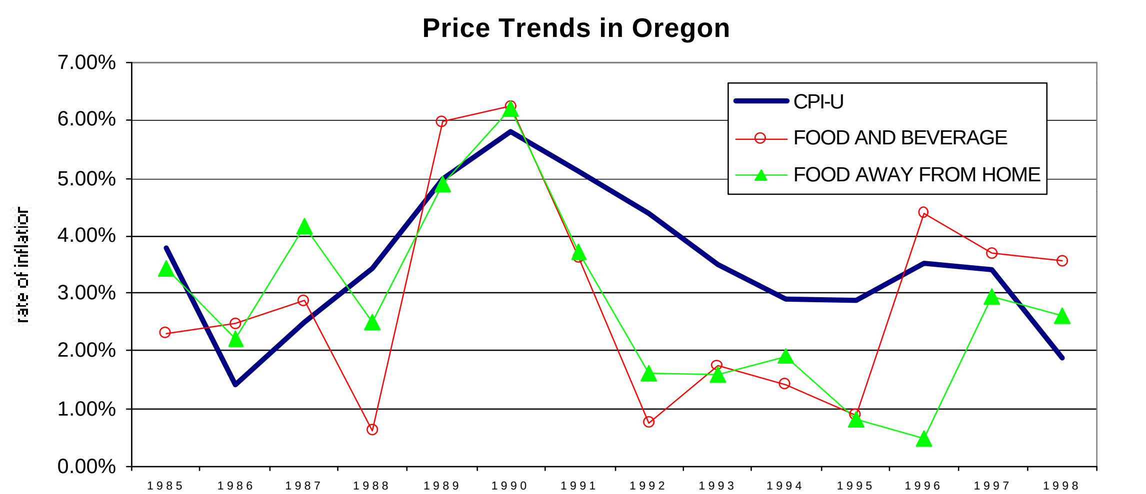
In addition, the employment data show continued growth for eating and drinking establishments, which would suggest that business closures among restaurants have not been significant. While it only currently extends through 1997, data on the number of eating and drinking establishments in Oregon reveals continued growth following the first phase of the minimum wage increase. In 1996 Oregon had 6,343 eating and drinking establishments, and by 1997 this number had climbed to 6,540.[19] Many successful restaurants, such as the Outback Steakhouse chain, have located in Oregon since the minimum wage increase.[20]

The sales outlook for restaurants in Oregon remains bright as well. According to the National Restaurant Association, eating place sales in Oregon from 1998 to 1999 are expected to increase more than 5 percent. This increase is faster than is expected for the Pacific region as a whole (covering Washington, California, Alaska, Hawaii, and Oregon) and also outpaces the growth of 37 other states.[21]

The Impact on Prices

Restaurant and other retail trade operators might respond to a minimum wage increase by raising prices. In the ORA survey, 79 percent of restaurant operators said that they had raised prices as a result of the 1998 increase. The study, however, did not address the extent of the price increases.

Figure 3



Source: Bureau of Labor Statistics, cpi-u segments

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[19] *Oregon Covered Employment and Payrolls*, 1996 and 1997 editions, Oregon Employment Department.

[20] Records from Oregon Secretary of State Corporations Division show the Outback Steakhouse first registered in Oregon in April of 1997. Other Outback Steakhouses have opened in Oregon since then.

[21] *1999 Restaurant Industry Forecast*, National Restaurant Association. Eating place sales are expected to rise from $3.040 billion in 1998 to $3.204 billion in 1999.

Figure 3 shows that, while restaurant inflation, referred to as “food eaten away from home” in the price data, did rise more quickly over the last two years, these changes have been moderate.

After experiencing very low levels of inflation for several years, restaurant prices did rise in 1997 and, to a lesser extent in 1998. The impact of these price changes on overall inflation, as measured by the consumer price index for the Portland area, however, has been quite limited. While restaurant prices were higher in 1997 and 1998, overall inflation fell in both years. Also, restaurant inflation was almost non-existent for several years before the minimum wage increases. The subsequent increases have simply returned restaurant inflation to the level of general price increases seen in the rest of the economy. In addition, it is not clear how much of the price increase at restaurants can be explained by the new minimum wage. Labor, after all, is not the only cost that eating and drinking establishments face. One important restaurant expense is the cost of the food and beverage that they prepare and serve. As figure 4 also shows, general food and beverage prices rose faster than restaurant prices and overall inflation in both 1997 and 1998. This increase in supply costs undoubtedly had some impact on menu prices.

The Impact on Earnings

Supporters of the increased minimum wage believe it raises the earnings of low-wage workers. Changes in workers’ real earnings are a measure of three things: the wage rate, the hours worked, and the inflation level. When the legal minimum is increased, there is the potential that real earnings might decline if prices were to rise quickly or hours worked were reduced substantially. This scenario, however, is purely hypothetical, because the data show that that inflation fell and average hours worked by retail workers rose slightly following the 1997 and 1998 minimum wage increases. Given this, one would expect real earnings to have gone up, and they have.

Table 2. Real Average Weekly Earnings (1998$)

	1995	1996	1997	1998
Retail Trade Industry	$270	$263	$273	$284

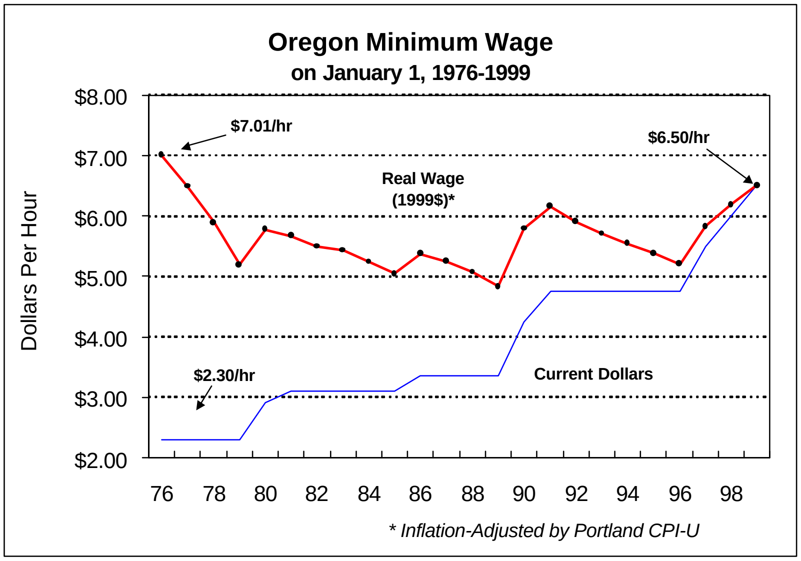
Source: Oregon Employment Department

Data for the retail trade industry show that *real* weekly earnings have risen substantially. Averaging $263 per week in 1996 (in 1998 dollars), retail workers’ earnings rose to $284 in 1998. Real earnings in 1996 had actually fallen from 1995, but the 1997 and 1998 increases were each approximately 4 percent. Lost average earnings in 1996 were more than made up for in 1997.

Inflation-adjusted earnings for retail workers were up in 1997 and 1998, and some of this increase is likely due to the minimum wage increases. As shown in *Figure 4,* the recent increases in Oregon’s minimum wage have finally reversed five years of decline in its real value. The purchasing power of the minimum, however, has still not returned to its 1976 level.[22]

[22] Oregon Employment Department, ***Labor Trends,*** December 1998.

Figure 4



Source: Oregon Employment Department, *Labor Trends*, December 1998.

The benefits of Oregon's minimum wage increases have been experienced by thousands of workers across the state. The 1999 increase, for example, is expected to raise the wages of the approximately 20 percent, or 195,000, of Oregon workers that were earning less than the new 1999 minimum wage by mid-1998.[23]

Wage increases have most likely also boosted wages of those earning above the new minimum. This phenomena, known as the "ripple" or "spillover" effect, has been documented in many minimum wage studies and is confirmed by restaurateurs responding to the ORA survey.[24] Sixty-two percent of the respondents reported having raised wages of those already receiving above the new minimum in 1998 as a result of the increase, and 50 percent planned to do the same for the 1999 increase.[25]

Conclusion

Recent increases to Oregon's minimum wage appear to have been successful. They have achieved the goal of increasing the earnings of thousands of Oregon's low-wage workers. In addition, the increases have not had any perceivable negative impacts on workers' hours or employment. The State's business climate has not been damaged, and the relatively small price increases at restaurants has not impacted prices in general, as inflation actually fell in 1997 and 1998.

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[23] U.S. Bureau of Labor Statistics Current Population Survey. (Second quarter 1998)

[24] The "spillover" effect is discussed in more detail in Card, D. and Alan Krueger, *Myth and Measurement*, pg. 160-166.

[25] Terborg, pg. 10.