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MINIMUM WAGE

THE WHITE HOUSE AUG 24 1995

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Are you vetting the minimum wage Executive order for Federal procurement?

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MINIMUM WAGE

EXECUTIVE OFFICE OF THE PRESIDENT

COUNCIL OF ECONOMIC ADVISERS

WASHINGTON, D.C. 20500

THE CHAIRMAN

August 30, 1995

MEMORANDUM FOR THE PRESIDENT

FROM: JOSEPH STIGLITZ
MARTIN BAILY MB

Subject: Proposed Executive Order Regarding Minimum Wage

Although we strongly support the Administration's proposal to raise the minimum wage, we have serious reservations about the proposed Executive Order on minimum wages for federal contractors.

- There is, to our knowledge, no substantive body of literature to support the proposition stated in the preamble that requiring federal contractors to pay a higher minimum wage will lead to increases in efficiency *sufficient to offset the cost to federal contractors of the higher wage*. Most of the economic literature has either focused on low wage sectors, like restaurants, or discussed effects of an across the board increase in the minimum wage.

- More generally, the effects of an increase in wages mandated in one sector of the economy (here the federal contracting sector) may be far different from those of an across the board increase in wages.

- Most economists would argue that if federal contractors' costs would have been lowered by paying higher wages, they would have already done so. Imposing *additional* constraints on contractors would normally be expected to increase total costs. (The preamble does not contain any refutation of this argument.)

- The magnitude of the increased costs may be significantly greater than the direct costs associated with increasing wages of workers at or near the minimum wage. The executive order will make it less attractive for firms to bid on government contracts (since it will raise costs on all production, not just on production for the government), and with fewer firms bidding, costs to the government will rise. More generally, the executive order is likely (if actively enforced) to interfere seriously with our efforts to reform government procurement policy, to make government procurement more efficient and less costly.

- There is some chance that the increased minimum wage will reduce employment among federal contractors--even under conditions in which an across the board increase in the minimum wage would not. Federal contractors could simply substitute high-quality high wage workers. Such policies could exert downward pressure on wages in other sectors of the economy.

There are a further set of technical issues not addressed by the executive order. Will contractors be responsible for insuring that subcontractors pay the $5.15 minimum wage? If not, this is an easy way for contractors to avoid the force of the executive order. But if contractors are responsible for enforcing minimum wages on subcontractors, it may impose significant economic costs. Each contractor will have to review the wage policies of all of its subcontractors (and its subcontractors of their subcontractors). For some, the share of federal business may be sufficiently small that they will be unwilling to revise their wage policy, necessitating entering into new contractual arrangements, presumably at greater costs. And what about products purchased on the market: does the contractor have to make sure that each product is produced by a manufacturer who pays the $5.15 wage?