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Minimum Wage - General

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minimum wage
– general

January 18, 1995

To: NEC Members

From: Gene Sperling

Subject: Minimum Wage

Attached is a draft of a minimum wage memo that would go to the President. It was drafted with the assistance of Alan Krueger at Labor. Please call me or provide written comments. If possible, it would be optimal to get comments by the close of business Thursday. At that point, the memo will be given to Leon Panetta for approval before going to the President. Please give consideration to the issue of when this decision should be publicly announced, as that remains somewhat unresolved.

Copy 3

On the minimum wage, there are three decisions that must be made: 1) whether to support a minimum wage increase; 2) if so, how much to increase it; and, 3) when to announce any decision. After several meetings and significant consultation with the Hill, the NEC has come to a single recommendation on the first two issues, while timing still represents a fairly open issue that must be resolved.

I. BRIEF BACKGROUND: The Federal minimum wage is currently $4.25 an hour. The minimum wage had been frozen at a nominal level of $3.35 per hour from 1981 to 1990. In 1990, Congress voted to raise the minimum wage by 90 cents -- in two 45 cents stages -- from $3.35 to $3.80 in 1990, and from $3.80 to $4.25 in 1991. The real value of the minimum wage is now above its value from 1988 to 1990, but is below its value for every other year going back to 1955.

The minimum wage has two important purposes. First, the minimum wage raises the bargaining power for low-wage workers who are not represented by a union and have low skills. The minimum wage may also have a "ripple" effect, whereby wages of workers earning somewhat more than the minimum wage are increased to maintain internal wage standards. As a result, the minimum wage helps many poor and moderate-income families. The second purpose of the minimum wage is that it induces firms to train their workers and take a high-value added/low turnover strategy -- it blocks the so called "low road" strategy of high turnover, high vacancies, continual recruitment, and low training.

II. EMPLOYMENT AND DISTRIBUTIONAL EFFECTS: The potential effect of a minimum wage increase on employment has been the principal argument raised in opposition to such an increase. While the potential employment effects of a minimum wage increase surely need to be considered, the weight of the empirical evidence suggests that the effect of a moderate raise from its current level is likely to be negligible. This conclusion is based on a variety of recent studies employing different methodologies; the studies examined the effects of raises in the federal minimum wage both across the nation and in particular states, as well as the effects of raising state minimum wages above the federal level.

For example, studies of the federal minimum wage examined the effects of a 90 cent increase in two increments over a two-year period. One of the state studies examined the effects of New Jersey recently raising its state minimum wage by 80 cents, from $4.25 an hour to $5.05 an hour; another examined the effects of California increasing its minimum wage 90 cents from $3.35 an hour in 1987 to $4.25 an hour in 1988 (which would equal $5.20 in 1993 dollars). All of these studies found that the minimum wage increases did not reduce employment opportunities. (These studies were conducted by David Card, Alan Krueger, Larry Katz.)

An important point to note about the minimum wage is that while there may be some who are teens or just providing a supplement to a family living comfortably, most are people who are either sole earners for their families or are providing vital support to help maintain a middle income existence. Indeed, 36% of minimum wage workers are the sole earner in their family, while the average minimum wage worker provides nearly 50% of the income in their household.

While increasing the minimum wage does help many people at the bottom of the economic ladder it is also, as mentioned above, important for families where a second income is keeping them barely in the middle class. For example, 43% of minimum wage earners are in the bottom 20% of income, 45% are in the middle 60% -- and only 12% are in the top 20%. Only about one-third of minimum wage earners are teens while two-thirds are adults. Some argue against the minimum wage because it is not as targeted as the EITC toward working poor families. Others find it to be a positive point that the an increase in the minimum wage would have such a positive effect on both working poor and middle income households.

III. RECOMMENDATION

NEC Recommendation: The general recommendation from your economic advisors as well as Leon Panetta, George Stephanopoulos and Pat Griffin was to call for a 75 cent increase over two years -- 50 cents the first year and 25 cents the second year -- bringing the minimum wage to a total of $5.00. The rationale for the two-stage increase to 75 cents is based on both our best estimate of what is sound economically, as well as representing a reasonable political starting point for a minimum wage proposal. From a political perspective, the most important single issue is the degree of support we can gather from Congressional Democrats for our proposal.

a) Economic Rationale: As mentioned above, the economic literature demonstrates that there is good evidence that a minimum wage increase under 90 cents does not have negative employment consequences. While a $1 increase may still be in the ball park, our feeling is that we would be on stronger footing if our increase was within the levels where the recent economic studies by Katz and Krueger showed no negative employment impact. Furthermore, at $5.00, the national minimum wage would still be below the highest state minimum wage levels -- New Jersey at $5.05 and Hawaii at $5.25.

There was also agreement among most of the economists on the NEC that 75 cents in one year might be too steep and that we were on sounder ground dividing it between 50 cents and 25 cent. Furthermore, a 50 cent increase immediately puts the minimum wage level back up to where it was when the last minimum wage increase passed in 1991. The additional 25 cents increase puts the number up to an even $5.00. While some may have found a 75 cents minimum wage increase to be small by historical standards, the minimum wage increase you call for must be also be considered in the context of the dramatic increase you proposed and signed for the EITC.

b) Political Rationale: As mentioned above, you must consider your recommendation both in terms of the statement it makes and the degree your proposal increases the chance of passage. A higher minimum wage increase is likely to be more satisfactory to those who most support the minimum wage increase -- organized labor and some progressive Democrats. The AFL-CIO calls for a $1.50 increase -- with three 50 cent increase plus indexing. Sabo and seven Democratic co-sponsors called last year for an increase in the minimum wage to $6.50 while denying employers a tax deduction for excessive compensation (more than 25 times the lowest compensation paid any other employee). Kennedy also supports a minimum wage increase close to the AFL-CIO recommendation. On the other hand, several Democrats in the

Senate have expressed some reservations about proposing a minimum wage increase, and would feel better if we kept the increase to a lower level.

Advocates who argue for a higher number increase state that since the chance of passage of the minimum wage with the present Congress is considered small by some, the proposal should at least accomplish the political goal of being satisfactory to labor. An argument for going for a lower number -- 50 cents -- is that it would be small enough to lessen intense opposition from some business groups while responding to the concerns of some Democrats who feels that an increase in the minimum wage goes against the "new Democrat" message. Furthermore, Pat Griffin and others felt that a 50 cent proposal had the best chance of passage.

We felt that a two stage 75 cent increase without indexing made the most sense from a political perspective as well as an economic perspective. First, while a 75 cent increase would be unlikely to satisfy organized labor and the most ardent supporters of the minimum wage, it would meet your campaign promise of making up the lost value due to inflation since the last minimum wage increase while adding 25 cents to spare, and it seems to be a level that could hold most Democrats in Congress together. Finally, to the degree that a one-time 50 cent increase represents the proposal with the best chance of passage, a 75 cent proposal gives us some negotiating room.

IV. INDEXING: The proposal that was considered for indexing would tie the minimum wage to the wages of the median worker or the 25th percentile worker. These standards are preferable to indexing to the CPI because they would avoid contributing to an inflationary cycle that could result if the CPI was used. The arguments for indexing are that it would protect the value of the minimum wage without making Congress continually have to seek new legislation. Politically, Republicans who oppose indexing would be put in the position of having to support indexing the capital gains tax cut for well-off Americans while opposing indexing for wages for workers at the lowest wage levels.

Nonetheless, the NEC and White House staff felt that a 75 cent increase was adequate without indexing. The arguments against it were the low chance of passage, the risk that it would be perceived as inflationary (even with our attempts to index to a measure other than the CPI), and the concern that the perceived benefit to workers would not be large enough to overcome the political downsides. Furthermore, even strong advocates of a stronger minimum wage increase might not support an indexing proposal because they would fear that indexing after only a 50 cent or 75 cent increase would lock them into too low of a level for the future.

V. ARGUMENTS AGAINST NEC RECOMMENDATION: Despite the fact that the NEC was virtually unanimous it its recommendation, we wanted to give you "cons" -- the opposing arguments you are likely to hear for either not increasing the minimum wage or, on the other hand, calling for a larger increase.

- **Hurts New Democrat Message:** Some Congressional Democrats believe that this works against the "new Democrat" message -- as an increase in the minimum wage is perceived as a traditional Democratic/labor agenda item and is likely to be vigorously opposed by small business. Arguing against this concern is the fact that while there will be intense small business opposition, polls consistently show that 70% of Americans support an increase in minimum wage. Other Democrats concerned about the minimum wage have argued that if we do propose a minimum wage that we package it together with other policies designed to increase wages for working Americans.

• **Will Create Opposition without Creating Strong Support**: A 75 cent increase is likely to run the risk of stirring strong small business opposition without generating strong support from organized labor which is likely to feel it is far too low. Arguing against this is the degree that we can work with Democrats to work together to draw a line on the side of working Americans against Congressman Armey and others who strongly oppose this popular issue.

• **Unfunded Mandates:** An increase in the minimum wage does affect some state and local governments who do pay the minimum wage for some jobs and therefore could claim that this is an unfunded mandate.

VI: TIMING: The main timing question is whether or not to announce your minimum wage decision in the State of the Union.

Pro:

• The State of the Union allows you to directly make your case over the heads of the special interests to the general public on an issue where the general public is with us.

• The State of the Union allows you to blend the minimum wage in with an overall strategy to raise incomes for working people.

• There has been considerable speculation about how we are going to decide this issue -- waiting past the State of the Union continues that process -- going earlier may distract from the build up to the State of the Union.

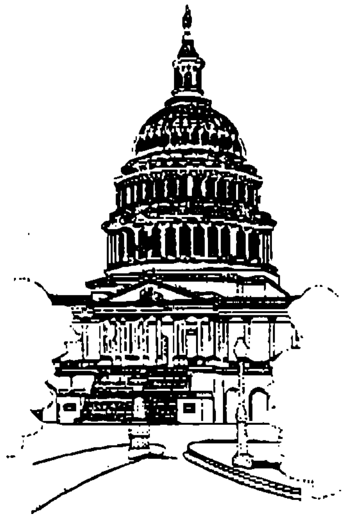
Con:

• A minimum wage increase in the State of the Union might be treated as a major news item that could distract from the basic messages in the State of the Union.

• There is still time to announce it prior to the State of the Union (though it would have to be almost immediately) or after it as a way of keeping our economic story going or building up to rewarding work for the welfare working session.

• The general -- though not firm -- recommendation was to go with the minimum wage increase in the State of the Union.

minimum wage
– general



Edward M. Kennedy

U.S. Senator for Massachusetts

315 Russell Senate Office Building
Washington, D.C. 20510
202/224-4543
202/224-2417 FAX

FAX TRANSMISSION

FOR IMMEDIATE DELIVERY

DATE/TIME: JAN 31, 11 AM –

TO: HAROLD ICKES

RECEIVING FAX#: 456-1121

FROM: SENATOR KENNEDY

NUMBER OF PAGES INCLUDING COVER:

COMMENTS:

THE MINIMUM WAGE

The starting point for the effort to increase the minimum wage should be an Administration proposal that calls for a 50-cent increase in 1995 and a 50-cent increase in 1996 to bring the wage up to $5.25.

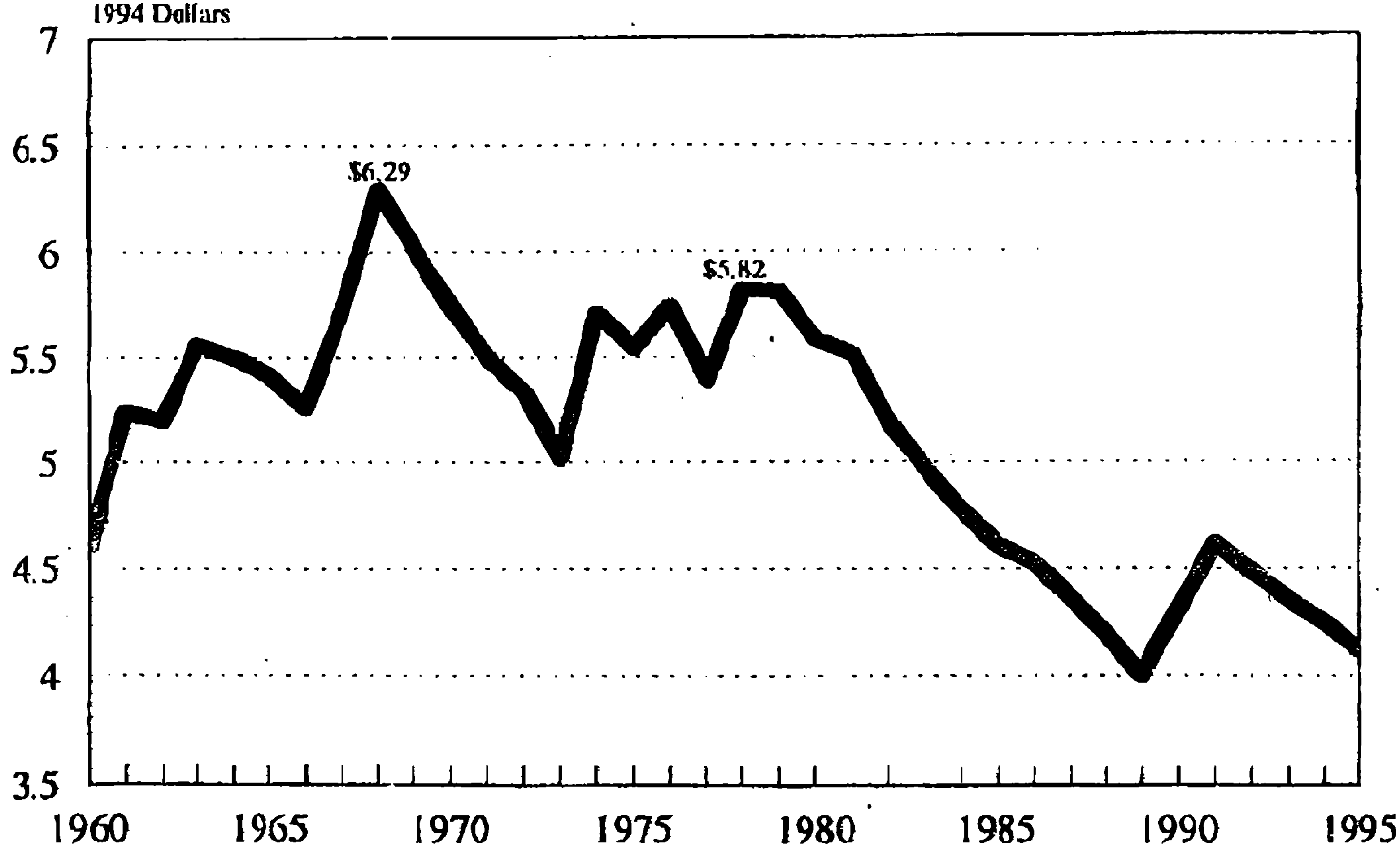
- This is just the beginning of the process. Inevitably we will have to compromise if we want to get a bill passed. If we start at $5.00, we're going to end up with an increase so low that we will not be able to claim it in the 1996 elections as a meaningful victory for working people.

- It is important that we start with a proposal that will appeal to and energize the Democratic party's base, especially labor. Labor has been willing to move some distance from where they would like to be for the sake of consensus on a number that a broader spectrum of Democrats can support, but we will lose them with a proposal that limits the second-year increase to $.25.

- An increase to just $5.00 over two years would do little more, in real terms, than restore the minimum wage to the level that Bush agreed to in 1989. With the Republicans in control of Congress, it would be a real accomplishment if we could pass a bill at or near that level, but to show that we are really on the side of working families, the Administration needs to send a clear message in the bill it proposes that unlike the Republicans, we believe in and support the principle that the minimum wage should be more than a poverty wage.

The Real Minimum Wage

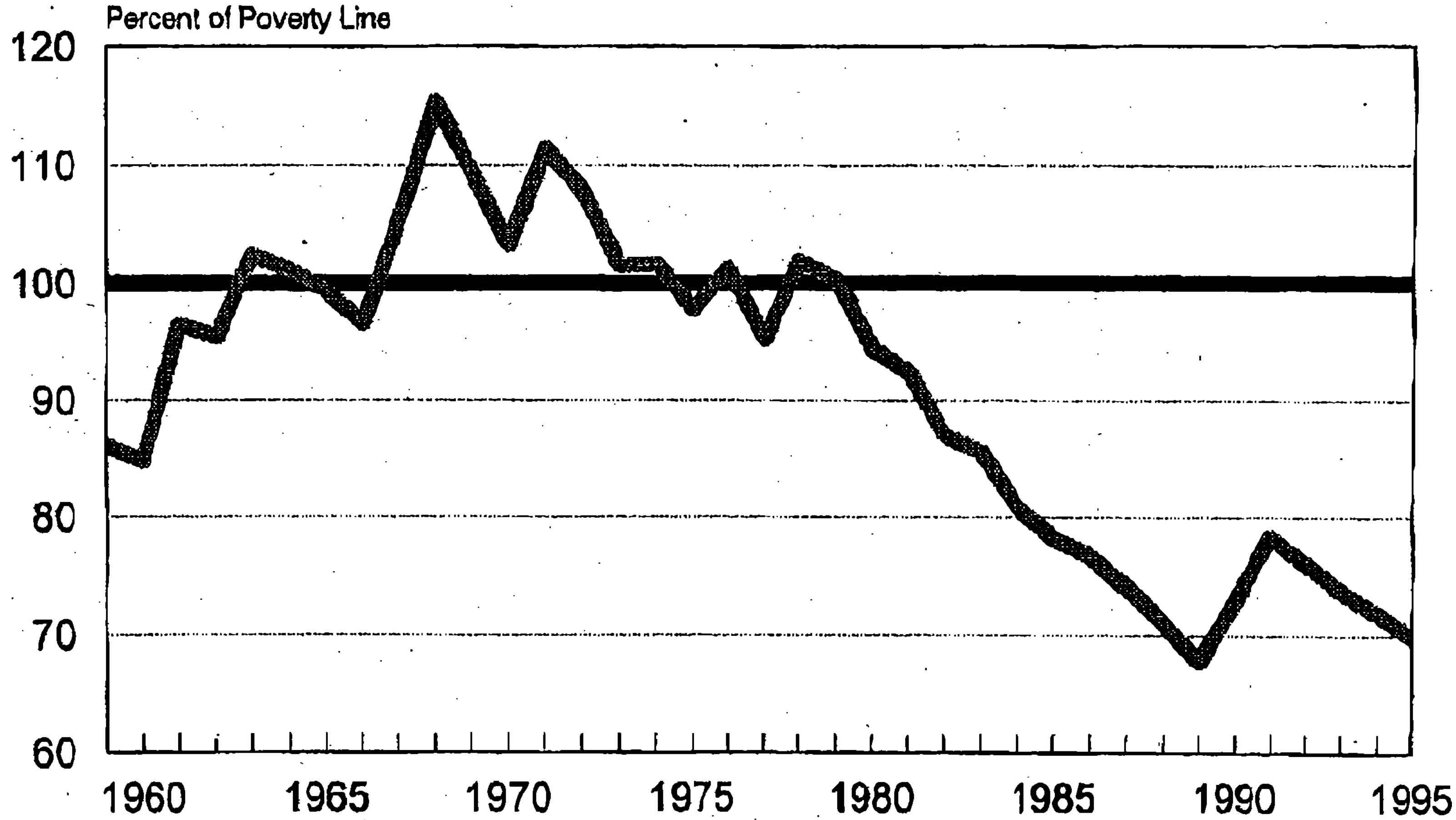
1960-1995



NOTE: Minimum wage is in 1994 CPI-U-X1 Dollars. The inflation rate for 1995 is assumed to be 3.2 percent.

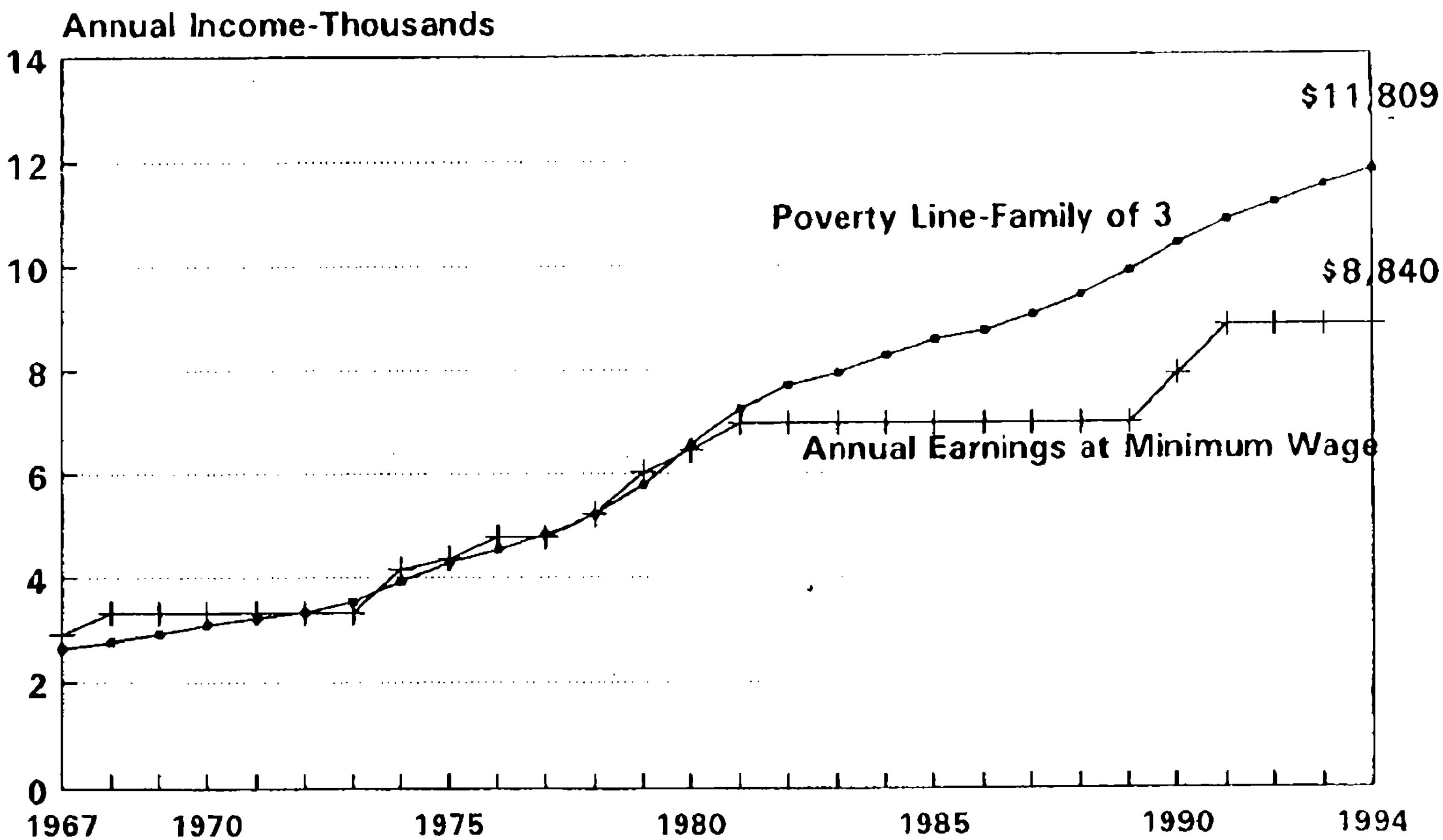
Minimum Wage Work No Longer Lifts Families Out of Poverty

Annual Earnings at the Minimum Wage as a Percentage of the Poverty Line: 1959-1995



Note: Annual earnings for a family of three with one full-time, year-round minimum wage worker as a percentage of the three-person poverty line. The three-person poverty line for 1994 and 1995 are from Congressional Budget Office projections.

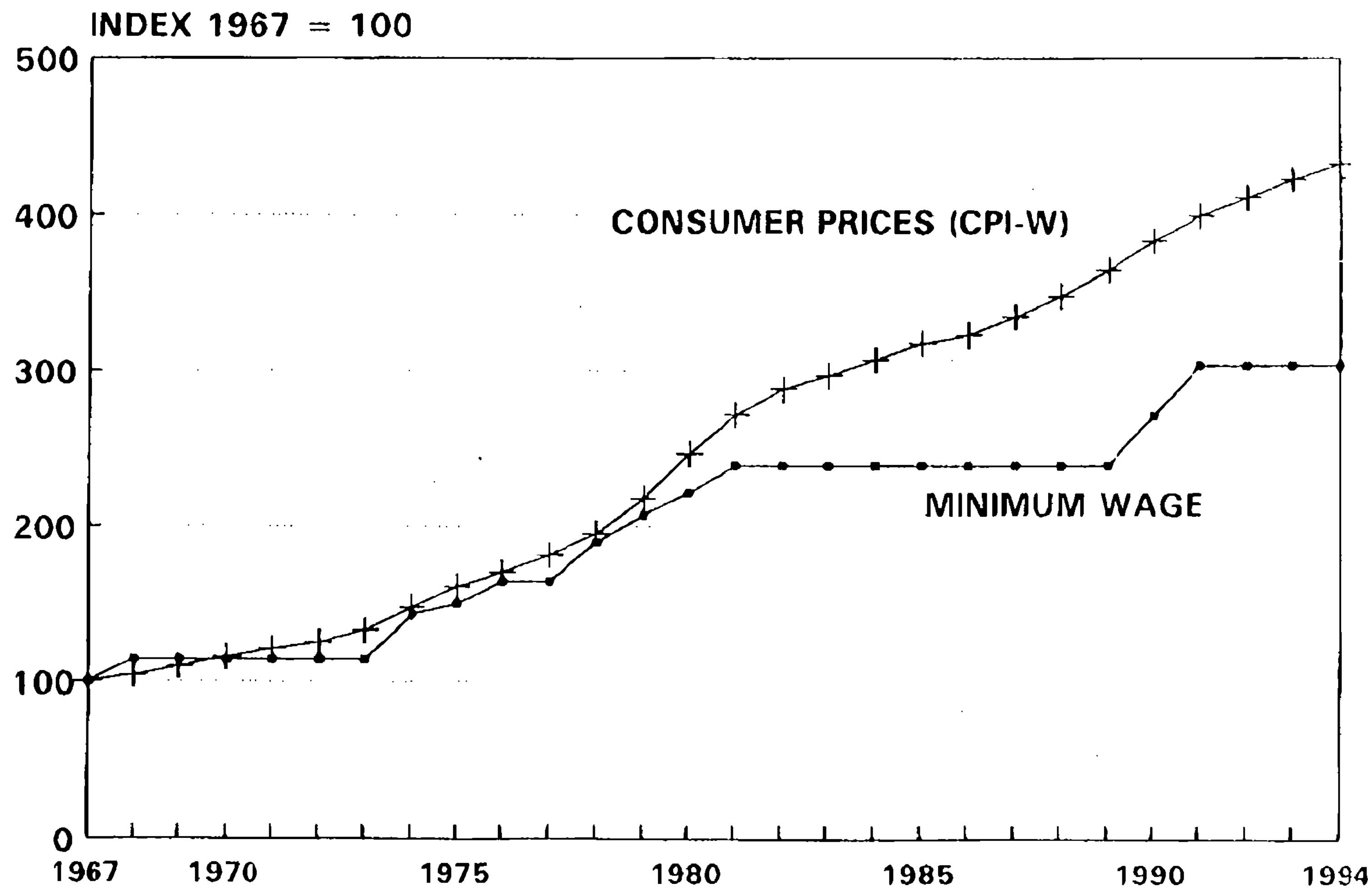
POVERTY LINES
1967 - 1994



Note: 1994 poverty line is est.

MINIMUM WAGE AND CONSUMER PRICES

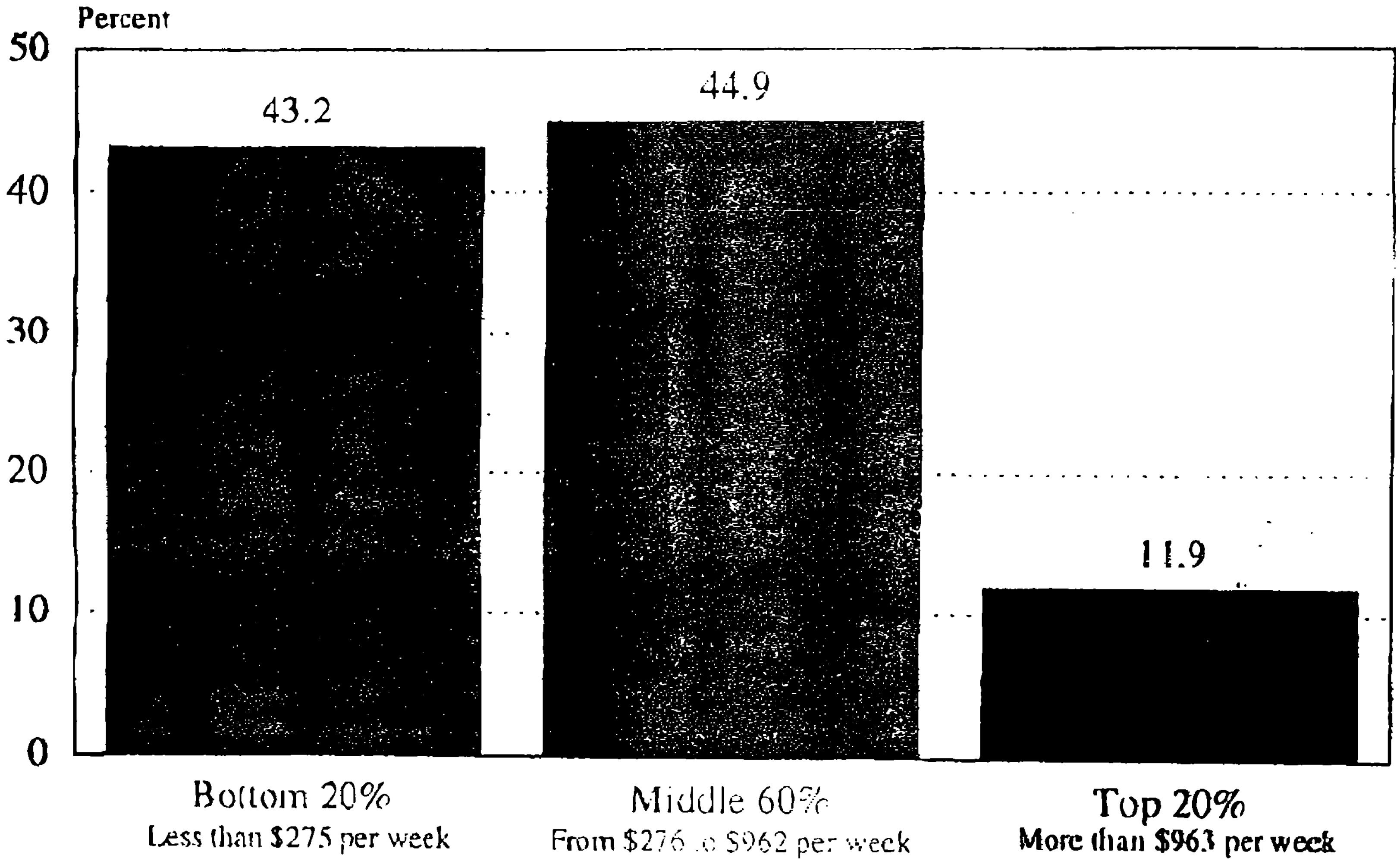
1967 - 1994



CPI ANNUAL AVERAGES. 1994 IS EST.

Who was Affected by the Last Minimum Wage Increase

Distribution by Family Earnings



Source: Card and Krueger (1995)

RECENT STUDIES FINDING NO DECREASE IN EMPLOYMENT FROM INCREASES IN THE MINIMUM WAGE

David Card and Alan Krueger, Princeton University (1994)

- Studied effects on employment in the fast food industry in New Jersey resulting from 1992 increase in the state minimum wage from $4.25 to $5.05. (This $.80 increase in 1982 followed a 1990 increase from $3.35 to $3.80 and a 1991 increase from $3.80 to $4.25.) Compared New Jersey to Eastern Pennsylvania, which did not increase its minimum wage beyond $4.25.

- Found no negative impact on employment; some evidence of positive impact on employment.

Walter Wessels, North Carolina State (1994)

- Studied effects on restaurant employment across states resulting from 1990 and 1991 increases in the federal minimum wage from $3.35 to $4.25.

- Found positive impact on employment.

Lawrence Katz, Harvard University, and Alan Krueger, Princeton University (1992)

- Studied effects on employment in the fast food industry in Texas of 1990 and 1991 increases in federal minimum wage from $3.35 to $4.25.

- Found no significant impact on employment.

David Card, Princeton University (1992)

- Studied effects on teenage employment across 50 states resulting from 1991 increase in the federal minimum wage from $3.80 to $4.25.

- Found no significant impact on teenage employment in low wage as well as high wage states.

Kevin Lang, Boston University (1995)

- Studied effects of 1990 and 1991 increases in the federal minimum wage across states on restaurant employment.
- Found no significant employment effects

David Card, Princeton University (1992)

- Studied changes in retail trade and teenage employment in California resulting from 1988 increase in the state minimum wage from $3.35 to $4.25. Compared California to other comparison states which had similar employment trends prior to 1988 but did not increase their state's minimum wage.
- Found no significant impact on teenage employment or overall employment in retail trade.

PUBLIC SUPPORT FOR INCREASING THE MINIMUM WAGE

Public opinion polls continually show considerable support for a minimum wage hike.

- A Time/CNN poll conducted January 25-26 found that 78% favor increasing the minimum wage and 20% oppose it.
- An NBC poll conducted January 25 found that 78% favor increasing the minimum wage; 18% oppose it.
- Another recent Wall Street Journal/NBC New poll found that increasing the minimum wage is favored by a margin of 75% to 20%. A breakout of support showed that support among women at 78%, support among blacks at 77%, and support among young adults ages 18 to 34 at 85%. These are the groups most affected by an increase in the minimum wage.
- Other polls have found that a majority of Republicans as well as Democrats favor a minimum wage increase.
- A majority of the public supports a minimum wage hike even if they are first told that a minimum wage rise will cost some people their jobs.

minimum wage / agenda

THE WHITE HOUSE
WASHINGTON

August 31, 1995

MEMORANDUM FOR ERSKINE BOWLES
HAROLD ICKES
BRUCE LINDSEY

FROM: JENNIFER O'CONNOR

SUBJECT: Proposed Minimum Wage Executive Order

Secretary Reich forwarded the attached proposed Executive Order (E.O.) which would require federal contractors to pay the President's proposed new minimum wage of $5.15 per hour. In his transmittal memorandum, he outlined the advantages and disadvantages of his proposal. The advantage is that it would demonstrate the President's commitment to increasing working families' wages. The disadvantages Reich discusses are twofold: 1) the policy rationale for such an E. O. is that it would increase overall economic efficiency; yet this finding is weak and not supported by the Department of Labor's economists; 2) the legal justification is also that the E.O. would increase economic efficiency; since the economists do not support such a finding, the E.O. is particularly vulnerable to a court challenge.

Also attached are memoranda from the following White House offices based on a quick review of the proposed E.O.: OMB, NEC, DPC, CEA, Vice President's Office, White House Counsel, Office of Legal Counsel at Department of Justice (OLC). None of these offices reported any positive reaction to the proposal. The criticisms they point out include: 1) it will not increase economic efficiency as claimed and because of this Administration economists will not support it; 2) it will make contractors stop doing business with the government which will drive up the government's, especially the Defense Department's, costs; 3) it will reduce employment among federal contractors; 4) there is no legal justification for the E.O. since it will not increase economic efficiency; 5) it will disproportionately hurt small and minority owned businesses; 6) it could add $2 billion to our budget; 7) it is inconsistent with the National Performance Review goals of reinventing federal procurement; 8) it is inconsistent with a reported conversation the President had with the Vice President shortly before vacation in which he promised not to do anything further to undermine procurement reform.

The OLC memorandum includes suggestions for how to change the draft E.O. such that it would be legally defensible and supportable. It's suggested changes require the President to be comfortable claiming that the E.O. would increase overall economic efficiency (even if his economists don't agree).

MEMORANDUM

DATE: AUGUST 29, 1995

SUBJECT: MINIMUM WAGE EXECUTIVE ORDERS

Summary

As requested, we have prepared a draft executive order that would prohibit government agencies from doing business with federal contractors that pay below $5.15 per hour.

Attached to this memorandum are: (1) the draft executive order relating to federal contractors and the minimum wage; (2) the press packet released by the White House on February 3, 1995 accompanying your legislative proposal to increase the minimum wage; (3) an excerpt on the minimum wage from your May 19, 1995 speech for the 75th Anniversary celebration of the Labor Department's Women's Bureau; and (4) a legislative background brief describing how members of Congress voted when the minimum wage was last increased in 1989.

Message

* The nation's leading economic problems are stagnant wages and declining real incomes for working families.

* The federal government should not contribute to the wage and income problems facing working families.

* The President has presented Congress with a legislative proposal to increase the minimum wage 90 cents from its current $4.25 per hour. This initiative would assure that people who work hard and play by the rules receive a living wage of $5.15 per hour. Congress has refused to act.

* If Congress won't act, President Clinton will. The President will use his executive authority to guarantee a living wage --- $5.15 per hour --- for everyone working in firms that do business with the federal government.

* At a minimum, the federal government should not do business with corporations that pay workers less than a living wage.

Discussion

I. Increasing the Minimum Wage for Employees of Federal Contractors

A. How the Executive Order Would Work

This draft executive order would establish that "[i]t is the policy of the executive branch in procuring goods and services that . . . federal agencies shall contract with companies that pay their employees no less than $5.15 an hour." This policy would be enforced in two ways. First, every government contract entered into after the effective date of the executive order (the date you sign it) would include a clause in which the contractor agrees to pay a minimum wage of $5.15 per hour. Second, any contractor that pays below $5.15 could have all of its government contracts terminated. The executive order does not provide for any exceptions.

The Secretary of Labor would enforce and administer the order. If the Secretary finds that a contractor is not paying a minimum wage of $5.15, he would transmit a finding to the heads of contracting agencies or departments who, in turn, must terminate all contracts with the contractor unless the contractor pays all of its employees at least $5.15 per hour within a time specified by the Secretary.

Like the "striker replacement" executive order, this draft order is premised on the authority delegated to the President by Congress in the Federal Property and Administrative Services Act of 1949 "to provide for the Government an economical and efficient system for . . . procurement and supply." Some economic theories suggest that increasing the wages of low-wage workers will result in an increase in those workers' productivity and, in turn, to increases in efficiency that will offset the cost to federal contractors of the higher wages. Thus, the federal government would, according to these theories, procure its goods and services from more efficient, more economical federal contractors.

B. Possible Variations in this Executive Order

(1) Use CEO Pay as a Trigger: The executive order could be made to apply only to federal contractors that pay their chief executive officer (or other top executive) more than 100 times the lowest wage paid to their employees. This approach would dramatize the growing wage disparity in our economy. On the other hand, it undermines the central moral argument which supports raising the minimum wage: every worker is entitled to a living wage, regardless of who employs them or how much others in their organization earn. Further, using a CEO pay trigger may weaken the nexus to economical and efficient procurement, the legal prerequisite for presidential action of this type.

(2) Use Profits as a Trigger: The executive order could also be made to apply only to federal contractors that earn above average profits. This approach would juxtapose the huge economic returns being yielded by capital (e.g., the soaring stock market) with the decline in

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middle and working class family incomes. On the other hand, it suffers from both of the infirmities outlined above (i.e., undermining the moral argument and attenuating the procurement nexus), plus it would require an administrative apparatus to decipher each contractors' profits.

C. Arguments For and Against the Executive Order

(1) Pro: This draft executive order will demonstrate your commitment to increasing working families' wages (particularly for the lowest wage workers) and distinguish you from a congressional majority that refuses to even consider your legislative proposal to increase the minimum wage. The minimum wage has fallen 27% in real terms since 1979 and, without adjustment, will fall to its lowest real value in forty years in 1996. It is arguable that the growing disparity in family incomes and wealth is the most pressing issue for middle and working class families. This executive order would make your moral position clear --- you will not allow the federal government to do business with any company that contributes to declining real wages for low-wage workers.

(2) Con: This executive order is premised entirely on economic theory, much of which will be difficult to explain in simple terms to the public, that is outside the mainstream of scholarly economic thought; accordingly, it is unclear whether reliable third parties will validate the arguments set forth in the preamble. Further, it is unclear whether theory alone is adequate to support an executive order. Even accepting the theories as true, it is also unclear whether the nexus between a minimum wage increase and efficient and economical procurement is sufficiently close to pass judicial scrutiny.

Preliminary research has not disclosed any executive order, outside the context of President Roosevelt's extraordinary powers during World War II, that directly sets wages for employees of federal contractors; that is, this executive order could be unprecedented. The closest analogy may be President Carter's Executive Order No. 12092 which required federal contractors to certify that they were in compliance with voluntary wage and price guidelines established by the President's Council on Wage and Price Stability. Finally, this executive order could lend support to attacks that President Clinton and the Democrats want big government. A slippery slope argument is easily made: "If Bill Clinton can require federal contractors to pay a higher minimum wage, is he going to require a pay increase for all workers? Will he require all federal contractors to follow his health plan? To finance abortions through their health plans?"

(3) Likely Constituency Responses: The labor movement and other advocates for low-wage workers will likely support the executive order. Federal contractor groups and representatives of the business community (e.g., the Chamber of Commerce, the National Association of Manufacturers), as well as the Republican congressional majority, will oppose the executive order. Since a substantially larger group of federal contractors will be affected, it is reasonable to expect a much more vigorous negative response from the business community than the striker replacement executive order evoked. Litigation and congressional

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action (e.g., efforts to overturn the executive order, appropriations riders blocking enforcement of the order) will likely result.

D. The EO's Costs Are Difficult to Estimate

A very rough estimate of the costs of the executive order suggests that it will cost federal contractors not more than $2.1 billion per year. Please note, however, that the data needed to make a precise estimate of the cost of the minimum wage executive order are not available. Estimates of worker wages and the number of workers involved do, however, permit this crude projection.

The assumptions employed to reach the above estimate likely bias the estimate upward. First, many federal contractors (e.g., construction, service) are required to pay a prevailing wage above the minimum wage by the Davis-Bacon Act and the Service Contract Act. Second, federal contractors' firms tend to be larger and, as a result, may have a smaller percentage of minimum wage workers than firms in the economy as a whole. Accordingly, the total number of workers affected by the executive order is probably smaller than that assumed in the calculations to reach the above estimate. Certain structural changes to the executive order (e.g., adding a threshold, narrowing the definition of "federal contractor") would further reduce the number of workers covered and the commensurate costs.

On the other hand, this estimate does not take into account any "ripple" effect that minimum wage increase might have on the wages of workers that currently earn $5.15 or slightly more. The ripple effect would tend to increase the costs of the executive order to federal contractors.

II. Two Approaches to Announcing the Executive Order

Should you decide to proceed, you should consider two approaches to announcing the executive order.

You could announce the executive orders in a speech --- such as your forthcoming address to the Alameda Central Labor Council's Labor Day Picnic --- or radio address and then sign the order soon before, the same day, or soon thereafter. This approach gives the White House control over timing and press arrangements. It also provides an opportunity to brief potential supporters without tipping off opponents. On the other hand, it could inspire congressional retaliation in the appropriations/reconciliation/debt ceiling process.

Or, you could announce in a speech or radio address that you are giving Congress a 90-day (or until Christmas or New Year's Eve) deadline before which it must enact your proposed 90-cent increase in the statutory minimum wage. If it does not act by the time the deadline is reached, you would issue the executive order. This approach puts the onus

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squarely on Congress' shoulders. It also allows you to wield all of your available authority to keep the minimum wage from falling to its lowest real value in 40 years (which it will in 1996 if there is no adjustment). On the other hand, this approach allows opponents time to organize and, possibly, to seek judicial intervention. It also offers words when bold action might send a stronger and clearer message.

<u>Attachments</u>

DRAFT 4
August 25, 1995

ENSURING THE ECONOMICAL AND EFFICIENT ADMINISTRATION AND COMPLETION OF FEDERAL GOVERNMENT CONTRACTS

PREAMBLE

Some economic theories suggest that requiring federal contractors to pay a higher minimum wage will lead to increases in efficiency that will offset the cost to federal contractors of the higher wage. The minimum wage has fallen 27% in real terms since 1979 and, without adjustment, will fall to its lowest real value in forty years at the end of 1996. Meanwhile, labor productivity has increased 17% since 1979.

These theories suggest that the productivity of low-wage workers is depressed when the minimum wage falls significantly in real terms. These conditions can lead to greater levels of "shirking" (i.e., reduced efforts by workers), higher turnover, lower morale, and longer periods in which needed jobs remain unfilled. Raising the minimum wage may lead to efficiency gains among federal contractors that employ low-wage workers by reducing shirking, lowering turnover, increasing morale, and reducing the periods of time during which needed jobs remain unfilled. In sum, productivity is lower when workers are paid an obsolete minimum wage and, as a result, the federal government receives lower quality, less reliable, and less timely goods for each taxpayer dollar. By paying a higher wage to low-wage workers, federal contractors will increase worker productivity. The federal government will procure its goods and services from more efficient, more economical federal contractors.

The market may not address this problem on its own. The problems of turnover, shirking, low morale, and extended job-slot vacancies likely result from a minimum wage which is too low to attract new workers and retain incumbent workers. However, employers cannot lure a new worker into a particular job with a higher wage without giving everyone else in that job a pay increase. Thus, in the absence of a requirement that they pay a higher wage, employers choose lower levels of employment and output rather than increasing the wages paid to all of their low-wage workers.

NOW, THEREFORE, to ensure the economical and efficient administration and completion of Federal Government contracts, and by the authority invested in me as President by the Constitution and the laws of the United States of America, including 40 U.S.C. 471 and 486(a) and 3 U.S.C. 301, it is hereby ordered as follows:

Section 1: It is the policy of the executive branch in procuring

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goods and services that, to ensure the economical and efficient administration and completion of Federal Government contracts, Federal agencies shall contract only with companies that pay their employees no less than $5.15 per hour of work. All Government contracting agencies shall include in every Government contract hereafter entered into the following provision:

> "During the course of the contract the contractor agrees that all employees of the contractor will be paid no less than $5.15 an hour."

Sec. 2.(a) The Secretary of Labor ("Secretary") may investigate any Federal contractor to determine whether the contractor is paying any of its employees less than $5.15 per hour of work.

(b) The Secretary shall receive and may investigate complaints that the contractor is paying any employee less than $5.15 per hour of work.

(c) The Secretary may hold such hearings, public or private, as he or she deems advisable, to determine whether any contractor is paying any employee less than $5.15 per hour of work.

Sec. 3. (a) When the Secretary determines that a contractor has paid any employee less than $5.15 per hour of work, the Secretary may make a finding that it is appropriate to terminate the contract for convenience. The Secretary shall transmit the finding to the head of any department or agency that contracts with the contractor. All Government contracts with the contractor shall be immediately terminated unless the contractor commences within a time specified by the Secretary to pay all of its employees no less than $5.15 per hour of work.

(b) Each contracting agency shall cooperate with he Secretary and provide such information and assistance as the Secretary may require in the performance of the Secretary's functions under this order.

Sec. 4.(a) The Secretary shall be responsible for the administration and enforcement of this order. The Secretary may adopt such rules and regulations and issue such orders as may be deemed necessary and appropriate to achieve the purposes of this order.

(b) The Secretary may delegate any function or duty of the Secretary under this order to any officer in the Department of Labor or to any other officer in the executive branch of the Government, with the consent of the head of the department or agency in which that officer serves.

Sec. 5. This order is not intended, and should not be construed, to create any right or benefit, substantive or procedural, enforceable at law by a party against the United States, its agencies, its officers, or its employees. The order is not intended, however, to preclude judicial review of final agency decisions in accordance with the Administrative Procedure Act, 5 U.S.C. 701 *et seq*.

Sec. 6. This order is effective immediately.

THE WHITE HOUSE

EXECUTIVE OFFICE OF THE PRESIDENT
COUNCIL OF ECONOMIC ADVISERS
WASHINGTON, D.C. 20500

THE CHAIRMAN

August 30, 1995

95 AUG 30 P8:20

MEMORANDUM FOR THE PRESIDENT

FROM: JOSEPH STIGLITZ JS
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.

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o 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?

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

THE DEPUTY DIRECTOR

August 30, 1995

MEMORANDUM FOR HAROLD ICKES

FROM: Jack Lew

SUBJECT: Minimum Wage Executive Order

This afternoon I received a copy of the draft executive order that would require all federal contractors to pay the proposed new minimum wage of $5.15 per hour. The following comments reflect our quick review. I have pulled together comments from Steve Kelman, Ken Apfel's shop and Bob Damus, our general counsel. Without addressing the merits of a statutory minimum wage increase, we think it would be a mistake to implement a minimum wage increase applicable to federal procurement only.

(1) Required finding is problematic

As a legal matter, any procurement-related Executive Order would need to be justified on the rationale that it promotes "economy and efficiency" in procurement. While it might be possible to identify a theoretical study that shows that improved morale increases efficiency, the common sense case would be difficult to make. There is a risk that the result would expose us to significant ridicule, i.e., that we think you promote economy and efficiency by spending more money and paying higher prices than others.

(2) Differential minimum wage would disrupt Federal procurement

Creating a differential minimum wage, which is higher for federal contractors than for all other employers, would cause many existing government contractors who also sell in the commercial marketplace to withdraw from government business. It is unlikely that many of these employers would be willing to disturb their existing wage structure (where a minimum wage increase would produce ripple effects on other wages within the company) in order to do business with the government. If fewer companies are willing to do business with the government, we will experience higher prices due to less competition. This contradicts the Administration's reinventing government efforts to attract more contractors to business with us and increase competition.

This will be particularly an issue for small businesses and minority contractors, with which the Administration is making efforts to expand opportunities.

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(3) Budgetary impact

It is not possible this afternoon to produce a precise budget estimate, but the direct wage effect alone could cost over $2 billion, not counting the ripple effect as wages near minimum climb as well. As noted above, in addition to the direct effect, there would be the added cost of reduced competition if there is a higher minimum wage for firms that do business with the federal government, as many firms opt to drop federal contracts to avoid the wage increase in their non-federal business. This indirect cost increase would not be present if there is a statutory increase in the minimum wage.

The cost of reduced competition will be most severely felt at the Department of Defense, which has already been experiencing significant problems in terms of contractors who are unwilling to do business with the federal government.

THE WHITE HOUSE

WASHINGTON

August 30, 1995

MEMORANDUM FOR ERSKINE BOWLES
HAROLD ICKES

CC: CAROL RASCO

FROM: Paul Weinstein

SUBJECT: **Proposed Executive Order On Increasing Minimum Wage For Government Contractors**

The DPC has read over the proposed Executive Order from the Department of Labor requiring any Federal contractor to pay a minimum wage of $5.15 per hour. While the goal of such a proposal is laudable, we believe the Order has some serious drawbacks from a policy perspective. First, we do not think that there will be any significant economic efficiency gains from the Executive Order. Second, as part of the Vice President's reinventing government effort, the Administration has been trying to reform the procurement system by reducing the number of socio-economic requirements placed on Federal agencies when they contract with the private sector. The issuing of this Executive Order would be inconsistent with the National Performance Review's procurement reform proposal. Finally, the Executive Order would have a negative budgetary impact at a time when we are struggling to identify funds to pay for Presidential initiatives.

THE WHITE HOUSE

WASHINGTON

August 30, 1995

~~95 AUG 30 P6: 27~~

MEMORANDUM TO THE PRESIDENT

FROM: LAURA TYSON
BO CUTTER

SUBJECT: PROPOSED EXECUTIVE ORDER REGARDING MINIMUM WAGE

We oppose an Executive Order requiring federal contractors to pay a minimum wage higher than the statutory minimum wage. (Gene Sperling is out of the country, but we believe he would agree.)

- As a matter of process, we should not make as complex a decision as this one with as little analysis as has been carried out to date.

- The proposed Executive Order would further complicate federal procurement, raising an additional barrier to working with the Federal Government, and would be inconsistent with the overall direction of federal procurement policy. We have not analyzed the long-run costs the Government would experience as firms shift away from federal work.

- The proposed Executive Order would raise federal procurement costs, and, therefore, because budgets will not expand, may well result in lower employment derived from federal procurement.

- The proposed Executive Order raises a number of other detailed issues we have not been able to analyze in this short a time period: How would the international operations of affected firms be treated? Would firms cut back on benefits? Are we legally able to terminate contracts?

- Finally, the basic justification for such an Executive Order -- that it would increase overall economic efficiency --is not supportable for a measure applying only to part of the economy. Larry Katz, who is, as you know, a leading proponent of this argument when applied to the whole economy, would probably publicly criticize it in this case.

- We think our current minimum wage position is right and a political winner. We do not need to jeopardize our position with one action we have not thought through. If you wish, we can initiate a process immediately to develop a more thorough analysis and provide you with a better basis for a decision.

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E X E C U T I V E   O F F I C E   O F   T H E   P R E S I D E N T

30-Aug-1995 04:54pm

TO: OCONNOR_J

FROM: Lee Ann Brackett

SUBJECT: minimum wage -- procurement eo

Jennifer,

Please tell Harold in ;the strongest possible terms that the VP would be very much opposed to the proposed executive order requiring federal contractors to pay a minimum wage higher than the statutory minimum wage. This proposal would run counter to all of the President's efforts in the area of procurement reform. The effect would be to cause many existing government contractors to withdraw from government business since these companies do not now produce products off separate product lines. Having fewer companies willing to do business with the government means both higher prices for the government and contradicts the Administration's efforts to lower the cost of goods and services through procurement reform.

In addition, the VP believes that he has a commitment from the President made at their last lunch before vacation that in the search for executive actions, we would not entertain any further actions that undermine procurement reform. If this does not die I will insist that the VP weigh in.

Elaine Kamarck

OFFICE OF THE VICE PRESIDENT
WASHINGTON

August 30, 1995

MEMORANDUM FOR HAROLD ICKES
ERSKINE BOWLES

FROM: ELAINE KAMARCK
KUMIKI GIBSON

SUBJECT: MINIMUM WAGE EXECUTIVE ORDER

We have reviewed the proposed Executive Order on "ensuring the economical and efficient administration and completion of Federal government contracts." We oppose the issuance of this Executive Order for several reasons.

First, please be advised that before leaving for their vacations, the President and the Vice President agreed that the President would not issue any new directives regarding procurement reform -- an effort being pursued as part of the National Performance Review. Second, we have serious concerns as to whether this order will in fact "increase efficiency," as it purports to do. Third, we question whether this order is defensible legally. Finally, we believe that this order may be viewed as purely political.

Please contact either one of us if you have any questions regarding our position.

Thank you.

THE WHITE HOUSE

WASHINGTON

DETERMINED TO BE AN ADMINISTRATIVE MARKING
INITIALS: JAM DATE: 12/1/17
2016-0531-F

~~PRIVILEGED AND CONFIDENTIAL~~

August 30, 1995

MEMORANDUM FOR ABNER J. MIKVA

FROM: CHRIS CERF CPC

RE: Minimum Wage E.O. Talking Points

* The proposed Executive Order would require federal contractors to pay employees $5.15 per hour.

* The D.C. Circuit has held that the President can "legislate" in this fashion only if he has the express or inherent authority to do so.

* The E.O. relies solely on the Federal Property and Administrative Services Act as the basis for presidential authority. Under D.C. Circuit law, the President may properly rely on the Act if there is a "nexus" between his actions and "the pursuit of economy and efficiency in the management of federal property."

* It is unclear to what degree a court would "look behind" a presidential finding that such nexus exists. Judge Kessler's opinion in the Striker Replacement cases implies that courts would give deference to such a finding, and there is some support for this in the D.C. Circuit.

* The Minimum Wage E.O. asserts that "some economic theories suggest that requiring federal contractors to pay a higher minimum wage will lead to increases in efficiency that will offset the cost to federal contractors of the higher wage." In other words, pay people more and they will be more productive and the savings associated with that productivity will be at least equal to the increased costs stemming from the higher wages.

* The Chief Economist of D.O.L. has informed me that there is no empirical evidence to support this theory. Moreover, although the theory has some support in the literature, it does not go so far as to suggest that there would be a full offset. In his view, "it is unlikely, but possible" that

the savings from the efficiency gains would fully offset the increased costs." He does think, however, that there would be some offset.

* The Office of Legal Counsel thinks that it is reasonable to assume (but not certain) that courts would more or less defer to a concrete presidential finding. They believe, however, that the E.O., as currently drafted, does not contain such a finding.

* To pass muster, the E.O. would need to delete all reference to "economic theories" (see above) and state outright that requiring contractors to pay a higher minimum wage would lead to increases in efficiency that would offset the increased costs associated with the wage.

* <u>The key question</u> is whether the President would be comfortable making such a finding. If not, the best guess is that the order would not survive judicial review.

* Even if we can make such a finding, there are substantial litigation risks. The outcome will depend on how "tight" a nexus the D.C. Circuit requires and whether it simply accepts the President's finding or allows the plaintiffs to challenge its factual basis.

Memorandum

Subject	Date
Minimum Wage Executive Order	August 30, 1995

To	From
Robert Damus General Counsel OMB	Teresa Wynn Roseborough TWR Deputy Assistant Attorney General Office of Legal Counsel

We have reviewed the draft executive order entitled "Ensuring the Economical and Efficient Administration and Completion of Federal Government Contracts" and the accompanying draft documents.[1] We believe that the determination that economy and efficiency in procurement will be promoted by the specific provisions of the order is legally available, if the assertions made in the order can be substantiated. That is, if the President determines, in good faith, that increasing the minimum wage of persons employed by federal contractors would promote economy and efficiency in federal procurement, we believe the issuance of the order would be authorized by the Federal Property and Administrative Services Act of 1949, 40 U.S.C. § 471 et seq. See Chamber of Commerce v. Reich, 886 F. Supp. 66 (D.D.C. 1995).

The supporting documents, however, do not suggest economy and efficiency in government procurement would be promoted by proposed provisions that would link the application of the order to CEO pay or company profits. Accordingly, we suggest that such provisions be eliminated from consideration. Below are our suggestions for strengthening the draft order and supporting documents:

A. The Executive Order.

We believe that the preamble articulates an economy and efficiency argument that may be sufficient to support the issuance of this order with the following alterations:

(1) The first and third paragraphs should be deleted because they weaken the economy and efficiency argument and seem to be contradictory and confusing. However, it may be possible

1 This memorandum provides our initial comments and observations. OLC review for form and legality is not yet complete.

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to fit the penultimate sentence of the first paragraph into the second paragraph.

(2) The President's authority to issue the proposed order is contingent upon his determination that it will promote economy and efficiency. Therefore, in the third sentence of the second paragraph, we believe the word "may" should be replaced with a less equivocal formulation, such as "I find that this order would . . . ." If the President cannot make such a finding, the basis for issuing the order would be doubtful. (While it is not necessary for the President to be absolutely certain that the proposed order will promote economy and efficiency, we believe that language that suggests a higher degree of certainty than "may" is necessary. In that regard, we suggest that, where possible, the language of this paragraph should be strengthened to reflect that the President holds a good faith belief that the proposed order will promote economy and efficiency in government procurement. See, e.g., Executive Order 12954, "Ensuring the Economical and Efficient Administration and Completion of Federal Government Contracts.")

(3) Finally, we suggest that the penultimate sentence of the second paragraph be amended to read as follows: "By paying a higher wage to low-wage workers, federal contractors will increase worker productivity, **improve the stability of their workforce, attract better qualified employees, and produce higher quality goods. Procuring goods from such contractors will promote economy and efficiency in federal procurement by (fill in the blank).**" (addition in bold) The last sentence of the second paragraph should be deleted.

The Striker Replacement Order provides that the Secretary's exercise of discretion under the order must be consistent with the policy stated in section 1 of the order. We believe that the Secretary's exercise of discretion under section 3(a) of the proposed order should be similarly limited. We therefore suggest the insertion of the following sentence at the end of section 3(a): "All discretion under this section shall be exercised consistent with the policy enunciated in section 1 of this order."

B. The Discussion Memorandum for the President.

We believe that the Memorandum does a very good job presenting the pros and cons of issuing this proposed order. Therefore, we limit our comments to three points.

First, the Memorandum fails to reveal the view of the Secretary of Labor as to whether the proposed order will promote economy and efficiency in procurement and does not include his recommendation as to whether the President should issue the proposed order. We believe that the President's determination that economy and efficiency in government procurement will be promoted by the proposed order would be substantially bolstered if it were supported by the recommendation of the Secretary.

Second, we believe that when discussing the different options for announcing the order it should be made clear that congressional retaliation in the appropriations/reconciliation/ debt ceiling process is a possibility regardless of the approach the President decides to take. While the memorandum only lists this possibility as a factor to be considered in the "sign immediately" approach, we believe that it is also a possibility if the President decides to announce his intention to act if Congress fails to enact legislation within a certain time period. In fact, utilization of the latter approach may provoke Congress to block the operation of the order through a prospective appropriation's rider.

Finally, we believe the discussion of the litigation risks associated with the order should be expanded. In addition to recognizing that the proposed order will almost certainly be challenged, we note that the issuance of the proposed order may have an adverse impact on the _Chamber of Commerce_ litigation, which is presently pending before the Court of Appeals in the District of Columbia. The court may be more reluctant to accept assertions of Presidential authority in _Chamber of Commerce_ knowing that this potentially would lead to broader assertions of authority. If the court were to view the proposed order as an indication that the President intends to legislate other than through bicameralism and presentment, this too could color the result of the litigation in _Chamber of Commerce_.

cc: Jennifer O'Connor
Chris Cerf