Hidden Costs Of Minimum Wage Increases

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A one-sentence California State Assembly Bill, less than 50 words in total, was recently signed into law. The legislation, Assembly Bill 10, increases California's minimum wage from $8 per hour to $9 per hour, effective July 1. Effective July 1, 2016, it will rise again, to $10 per hour. The 2014 increase will be the first increase to California's minimum wage since 2008 and the 26th time in the Golden State's history. California has come a long way since 1916, when minimum wage was $0.16 per hour.

During the debate on the legislation, arguments in opposition tended to focus on a number of claims: California's economic recovery will take a U-turn with employers unable to increase projected job growth; the legislation will force employers to reduce costs in other areas, such as labor, or pass costs in the form of higher prices for consumer goods, decreasing domestic competitiveness; etc. But what about the hidden costs of California's minimum wage increases?

Unfortunately for certain industries, particularly the restaurant industry, discerning the impact of increases in the minimum wage is not as simple as calculating the number of minimum wage employees, adding up their annual hours worked and decreasing projected profits by one dollar for every hour worked.

Hidden costs include: rising salaries and increased compliance costs for exempt employees; rising wages for higher income earners; and entry-level price floor increases.

Salaries for exempt employees will necessarily rise and not by a small margin. In the two years over which California's minimum wage is scheduled to increase, salaries for various exempt employees will rise at a rate much higher than projected inflation. In fact, salaries for various exempt employees will rise by 25 percent. That's right. In two years, certain salaried employees, who already make at least 200 percent of minimum wage, will see their wages increase by 25 percent.

Under California law, the minimum salary for an exempt employee — someone who does not qualify for overtime or certain meal or rest break regulations — is calculated at twice the minimum wage. Currently, employees cannot be lawfully classified as exempt if they make less than $33,280 annually. But when the minimum wage increases to $10 per hour, employees will need to make at least $41,600 to meet exemption requirements. The increase will severely affect businesses — much more than the effect of the increase in minimum wage.

Since the exempt employee increase is a hidden cost of the forthcoming minimum wage increases, it is also likely to trigger other substantial costs to employers — professional compliance costs. Employers who do not recalculate the salaries of certain exempt employees may face wage-and-hour lawsuits by single plaintiffs or class actions. With hidden costs, lawsuits are inevitable. For employers who proactively retain counsel to audit their employee salaries, there is the sunk cost of time and money expended for compliance.

Certain salaried employees, such as managers and certain full-time employees, will be 25 percent more expensive for employers starting July 1, 2016. Assuredly, this will come as a real shock for certain restaurateurs, including franchise owners, many of whom see annual profit margins as low as $55,000, as they face large start up costs and liabilities.

Aside from minimum wage earners and salaried employees, all other employee wages are likely to rise. Many employees earn raises based on performance or seniority. But what about employees who currently earn $0.50 per hour more than minimum wage? That is $0.50 per hour more than some of their colleagues. Certainly the inequities of giving them another $0.50 per hour July 1 would seem an affront to them when their currently lower-wage colleagues earning $8 per hour will earn another $1 per hour on the same date.

If nothing else, the morale costs could be enormous. Franchise owners set pay scales according to performance, seniority and other merit-based factors. A lot of time is spent on keeping employees content. In an organization such as a franchised restaurant, hierarchy is important. One way that the hierarchy is reflected is in salary differentials. But a 25-percent increase in the minimum wage over two years may negatively affect the ability of employers to retain salary differentials. In many cases, the profit margins are simply too low to retain the same salary differentials when the floor of the model increases by 25 percent. Minimum wage earners will increase their pay by 25 percent, and certain salaried exempt employees will receive an additional 25 percent. In organizations with minimum wage earners, will every employee need to receive a 25-percent pay increase in order to maintain salary differentials?

Finally, in many businesses, starting pay will rise to levels higher than minimum wage. This might be labeled a competition cost. Fast-food employers in metropolitan areas often do not start employees at minimum wage. Often such employers offer starting wages between $0.50 and $2 above minimum wage to attract better-qualified employees. Oftentimes the business model of paying above market rate engenders employee loyalty and hard work. Raising the minimum wage may mean that employers interested in such business models will need to pay between $10.50 and $12 per hour to new employees.

Exempt employee salary increases, compliance costs, seniority costs and competition costs are not found in the one-sentence legislation. But these hidden costs will significantly affect a large portion of the restaurant industry. Perhaps more than the salary increases for minimum wage earners.

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