
Ercan Sirakaya

Sloan Professor of Tourism
University of South Carolina, Columbia, SC, USA

Dr. Ahmet Caliskan

Faculty of Economics and Administrative Sciences
Fatih University, Istanbul/Turkey

The Likely Effects of Planned Minimum Wage Hikes for the Tourism Industry in the US

It has finally happened! Since almost a decade ago, a long overdue minimum-wage increase will be pushed through both houses of the congress if Democrats were to keep their midterm election campaign promises. The proposal seems to have been stalled for now, but it is coming. I received a few phone calls from reporters of national newspapers asking me about what would its impact be on the tourism industry. Wouldn't raising the minimum wage wipe out so many jobs and thus hurt the economy overall? Legitimate concerns!

My immediate reaction was to explain classical economic theory that when wages go up, there will be pressure by the employers to cut down on service and/or raise prices and thus make them less competitive in the market. However, I requested time off so I could think and dig for other possible outcomes; as we all know Econ 101 lectures do not hold in real life situations where one needs to take into account a multitude of factors. I also immediately enlisted the help of my classical economist friend, Dr. Ahmet Caliskan Together, we authored this little opinion piece.

We looked for evidence of both sides of the coin. The more we dug the more confusing became the issue. It basically turned into a normative political issue rather than a positive economic issue. Throughout this piece, we will discuss both economic and marketing perspectives. While, we both are aware of the humanistic implications of this basically philosophical and economic question for many families and employers in tourism, we will remain focused on a positive analysis of the issue. We'll stay away from normative questions like 'if it's good or bad' for any side.

What does the current evidence suggest? Does raising minimum wage cause unemployment? What will its impact be on the economy as a whole? How will it affect the tourism industry? Will we see differential effects in different sectors of the tourism industry? If so, what course of action would we suggest to the employers in tourism? Although we would like to give answers to all these questions, the space within this paper would not be sufficient to present a meaningful analysis of the entire spectrum of answers. We'll review the evidence a little bit and summarize what we believe might happen. The ultimate judge will, again, be time.

Here is what we know thus far in terms of the state of the minimum wage. According to the U.S. Department of Labor Employment Standards Administration (see <http://www.dol.gov/esa/minwage/america.htm>), there are more states that have their own minimum wage higher than the federal, only 15 states kept their minimum wages at the Federal level, when you look at the map of the states that have minimum wage with the current level you'd realize that most of them are republican. California, a traditionally democratic state, for example, has a minimum wage of \$7.5/hr and that will be raised to \$8.00/hr by next year. Some

states even mandate an automatic wage increase indexed to the rate of inflation. For example, since 2002, Oregon has mandated automatic annual increases to keep up with inflation. Oregon's 100,000 or so minimum-wage workers are being paid at least \$7.80, well above the federal \$5.15 minimum (Solomon 2006). It seems that most state legislatures are sensitive to this issue and do pass laws to keep it higher than the federal government. So, it is not news for most of the states. In terms of large tourism states like Florida, California, and New York, the effect will be negligible as these states are already paying their employees more than the minimum wage. The new rate will affect the states that were caught dumbfounded by such a bold move of the new congress. However, if an employer within these states were proactive and scanned its environment for clues as to what's going on in its general business & political environment, it would have made necessary changes long before a congressional mandate. How long one can expect to see sustained low-wages when prices of everything else show an upward trend? Now, these employers will be hurt, there is no doubt, at least in the short term.

We also know that the neoclassical economic theory predicts an increase in the unemployment rate when the general level of wages increases assuming that everything else is held constant. As we know, in the real world nothing is constant and new empirical evidence suggests quite the opposite. A landmark study published in a book "Myth and Measurement: The New Economics of the Minimum Wage" by Princeton economists David Card and Alan Krueger show empirically that minimum wage increases help increase employment. In a critique of their work, however, Texas A&M professors Donald Deere and Finis Welch support the traditional view (see <http://www.cato.org/pubs/regulation/reg18n1c.html>). There are hundreds of other studies that claim to find negative employment effects of minimum wage hikes. The data seems to give conflicting results. There is deep controversy on the issue. In fact, David Card and Alan Krueger's (and Lawrence Katz's) empirical results are in minority. The reader might want to check the following webpage to see that so many others seem to find results conflicting with their results and supporting the traditional view (<http://www.house.gov/jec/cost-gov/regs/minimum/50years.htm>)

But still, Card and Krueger quote an extensive collection of empirical studies in their book that support their argument. It seems that the theory and empirical evidence are at odds. Our opinion is that the theory needs revising, if it cannot be supported by empirical evidence. In fact, there is a relatively new theory that seems to garner much support by empirical studies: it is called the 'efficiency wage model' which argues that a minimum wage hike could increase employment. Quoting Southwest Learning web page (http://www.swlearning.com/economics/policy_debates/increase_minimum.html), "The efficiency wage model suggests that firms that pay workers a wage above the equilibrium wage will find that the higher pay results in more productive workers. The higher pay results in less labor force turnover, lower training costs, and better motivated workers. If the increase in labor productivity is sufficiently large, an increase in the minimum wage need not reduce employment." The same webpage includes a long list of scholars on both sides of the controversy. The issue of minimum-wage becomes political when there is no conclusive evidence into either direction. So, the new voter-conjecture demands such a move and democrats are taking advantage of it.

We have, of course, established our own views after reading and synthesizing so many empirical studies. Here is what we feel (our theory) the effect will be: We predict that there will be differential effects for different sectors of the tourism industry. We will try to evaluate the effects first from a macroeconomic perspective both in the short-term and long-term. In the

short-term, there will be reallocation of resources and workers. Businesses will not be able to raise their prices suddenly as they would lose the customers, so they will have to absorb the wage-hike and see a real decline in their bottom line. We believe that small business owners will be more negatively affected by such hike than mid-size or larger employers. In the long-term however, the prices will be adjusted and passed on to the customer so the effect will be more tolerable. One benefit of this might be that employees with better pay will be more committed and satisfied with their work and less likely to change jobs, thus eliminating the cost of retraining, which could mean huge savings for an industry that turnover rate seems to be a pandemic. In the longer term, within two or three years time for example, more welfare recipients or unemployed will go on the market to look for a job since they will find the increased wage-levels more attractive than staying at home. Second, the economy will get a spending boost and through inter-industry linkages new jobs will be created. "Minimum-wage workers are the only class of workers you can give a raise to and guarantee that they're going to spend the money and spend it in the local economy," says Dan Gardner, Oregon state labor commissioner. "They're not saving for a Hawaiian vacation." (*In Salomon 2006*). This line of reasoning did, indeed, work in the case of Florida when Florida has raised its minimum-wage. Despite the outcry by the employers, the state saw 200,000 jobs created a little over a year after the hike. For example, minimum wages for businesses that employ tipped employees (like waitresses in a restaurant) might see no effect in wage increases since they by law are allowed to pay less than the federal minimum wage (the federal minimum cash wage for a tipped employee is \$2.13), they will continue to give this (not in Kansas though, Kansas has a minimum cash wage of \$1.59, do not ask us how this is possible?). For the interested reader, U.S. Department of Labor Employment Standards Administration lists minimum wages for tipped employees on this web page: <http://www.dol.gov/esa/programs/whd/state/tipped.htm>.

We view this hike as positive for the entire economy. We think this type of boost will make a difference in the overall spending in the economy, thus creating new jobs. However, it will put inflationary pressure on prices that, in turn, might eat up most of the hike within a few years. Newly created jobs may not necessarily be in the tourism industry, but nevertheless as a whole the economy might get an extra boost other than the 'tax relief hype' that burdens the federal and local governments. Since we live in a complicated world, no one can expect and accurately measure the effect of everything. We think instead of worrying too much about what the federal government might do, the industry leaders and business owners should be leaders of innovation by understanding the needs and wants of their both internal (employees) and external (customers) stakeholders and provide quality experiences for both employees and guests. The minimum wage will not be an issue for most customers, as they value good quality service and thus pay accordingly. As a step towards getting used to this idea, we'd suggest that tourism businesses start raising their price levels of their services and goods little by little to diffuse a likely negative effect.

References

Deborah Solomon (2006). Weighing Minimum Wage Hikes Oregon's Boost Didn't Curb Growth, but Did Squeeze Some Employers. *The Wallstreet Journal Online*. November 3rd issue, Page A4.