

The Economic and Fiscal Impact of Connecticut's Proposed Statute to Recoup Costs Attributable to Low-Wage Employers

Executive Summary

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Introduction

State and local governments across the country, as well as the federal government, face increasing costs to sustain workers who are not paid enough to achieve basic economic security.¹ The growth of low-wage work in Connecticut has implications for both those whose earnings are insufficient to meet their families' needs and for the economic and fiscal problems facing the state. The state's taxpayer-supported social programs have attempted to accommodate the growth in low-wage work so that these workers can make ends meet. Employers whose strategies impose costs on society must recognize the squeeze this puts on government spending that could otherwise support programs favoring broad economic development.

In light of these challenges, a statute has been proposed in the Connecticut legislature (SB 1044, see note 5) that would levy a fee on private, for-profit employers (firms and franchises) of 500 or more workers, some who earn \$15 per hour or less.² The fee is \$1.00 for each hour such workers accumulate in a calendar quarter. As proposed, firms with less than 500 employees would pay no fee, while larger firms would pay according to their total low-wage (\$15 per hour or less) hours worked each quarter, including overtime hours.

This brief identifies and quantifies the costs and benefits of the proposed statute using an economic model of the state's economy.³ A more detailed analysis and presentation of findings will be available in a forthcoming report.

Key Findings

- The fee collected from covered employers would generate an estimated \$188,592,170 in new revenue for the state.
- Firms may adopt a variety and mixture of strategies to absorb the fee, including reducing their profit, passing part or all of the fee cost on to consumers and other firms, improving efficiency, employing more automation and reducing employment. We model the following three strategies:

- If covered firms reduce their sales by the fee amount, net state employment increases by 532 jobs, state GDP increases by \$92.4 million, and net state revenue increases by \$183.86 million.
- If firms and their customers share the fee cost equally, net state employment increases by 960 jobs, state GDP increases by \$111.5 million, and net state revenue increases by \$186.7 million.
- If covered firms' customers bear the full cost of the fee, net state employment increases by 1,388 jobs, state GDP increases by \$130.57 million, and net state revenue increases by \$189.7 million.

Discussion

The proposed statute provides for a quarterly fee collection period, allowing for seasonal fluctuations in low-wage employment as well as for cyclical, structural and frictional employment changes that affect total employment. In modeling the fee's impact, we regard the fee as a non-wage labor cost akin to an excise or per unit tax. The fee will affect firms in certain industries more than others because of the occupational structure of the industry. We make this clear as we present the data driving the economic and fiscal impacts.

We estimate the number of low-wage hours (that is, hours worked at firms with 500 or more employees who are paid at \$15 an hour or less) in Connecticut in 2014 to be approximately 188,592,170.⁴ Assessed on each of these hours worked, the \$1 per hour fee would therefore generate an additional \$188,592,170 in revenue for the state annually. These dollars drive the economic and fiscal impacts.

The fee revenue will flow into the state's General Fund and be disbursed to the Department of Social Services (DSS), the Department of Developmental Services (DDS) and the Office of Early Childhood (OEC), as well as the Department of Labor for its role administering the law. An advisory board will "advise the Labor Commissioner, the Department of Social Services and Developmental Services and the Office of Early Childhood generally on matters related to the implementation of the low-wage employer fee, public assistance usage among working residents of the state, improvement of the quality of public assistance programs affecting such residents, wages and working conditions for the workforce delivering services to low-wage working families and reliance of large businesses on state-funded public assistance programs." We assume the funds flow to their highest and best use through the board's diligence.

Further, the statute charges the Department of Labor with collecting the fee quarterly and hearing complaints. These actions incur costs that the Office of Fiscal Analysis estimated to be approximately \$311,962 in FY 16 and \$415,950 annually thereafter for salary (\$75,000) and fringes (\$28,988) associated with the hiring of four staff attorneys to hear complaints and \$11.1 million in FY 16 and \$14.8 million annually thereafter for program administration.⁵

While this policy clearly intends to recapture a portion of the costs low-wage firms impose on the public sector and taxpayers, we assume that for some firms the wage gap (the difference between \$15 and current wage rates for their low-wage employees) far exceeds the \$1 fee and they may choose not to raise wages. Increasing wages by any dollar amount per hour incurs payroll taxes and unemployment insurance costs, and perhaps other employee benefit costs related to hourly wage rates. Further, raising hourly wages of workers below \$15 per hour creates pressure on hourly wage earners immediately above the \$15 per hour threshold (wage compression). Firms contemplating raising low-wage hourly rates would want to make adjustments in their broader wage structure.

There are a range of responses firms may adopt to accommodate the fee. Many firms will absorb the fee in reduced profit, especially if they have market power in the labor market and earn extra-normal profit (a condition that is likely for the large firms the proposed statute covers). It is possible that some firms will pay the fee and adjust their cost and pricing structure such that profits are not reduced. Some of the fee cost may be passed to consumers in higher prices. Some of the fee cost may encourage firms to employ more machines, computers or other automation strategies. Some firms may reduce benefits and some may reduce employment. Others will try to improve efficiency and productivity in their operations in an attempt to absorb the increased cost. Some firms will file a complaint and seek relief if possible, incurring costs for the firm and the state. In reality, firms may employ a combination of these strategies to accommodate the fee.

If firms absorb the fee in reduced profit, there may be no discernible adverse economic effect because sales and employment will likely remain unchanged. In this case, firms would report lower profit and pay less tax to the state and federal governments. This phenomenon cannot be modeled using our economic model of Connecticut (IMPLAN).

Even if prices are increased to absorb the fee, the impact is likely to be minimal, because the total fee is quite small relative to Connecticut's firms' sales on the one hand and consumer final demand (that is, how much households buy in state) on the

other. Domestic and foreign sales by all Connecticut businesses was \$383.3 billion in 2013.⁶ Final consumer demand in the state in 2010 was \$162.5 billion (note 6). The estimated \$188.6 million fee from the policy change represents 0.12 percent of consumer demand (in 2010) and 0.049 percent of Connecticut's business sales in 2013. Further, the state collected \$16.4 billion in taxes in FY13–14 (DRS Annual Report) of which the fee represents 0.115 percent.

For purposes of this report, we provide three scenarios in which the costs of the fee 1) are borne entirely by consumers, 2) shared equally between consumers and producers (firms), and 3) borne entirely by affected firms.⁷ These scenarios ignore the mixture of strategies firms might adopt to absorb the cost because we have no way to determine what the mix or proportion of the cost applied to any strategy such as increased use of machines, reduction in employment, efficiency gains or pass-through to buyers (consumers and other firms). These scenarios provide a range of possible behavioral responses to the fee while not exhausting all possibilities including that some firms may leave the state.

Table 1 shows the summary results of the economic and fiscal impact analysis for each scenario described above (impacts measure changes due to the policy change). Total net employment consists of the direct and indirect employment effects and the relatively large positive effect of increased government revenue (begetting a relatively large increase in public sector employment), offset by reduced firm sales and employment. Value added is a measure of the value of goods and services produced in the state in a year and represents part of the state's GDP. Net state and local taxes consist of income, sales and property taxes on households and businesses. In the case in which we assume firms bear the full burden of the fee (no pass-through), taxes decline because of reduced sales.⁸ In the case in which households bear the full burden of the fee via complete pass-through, household tax gains (from increased state employment) are larger than business tax declines. The detailed methodology and IMPLAN modeling strategy as well as the 10 industries principally affected in each scenario are available on request.

As mentioned, part of the fee revenue supports administrative and complaint resolution costs at the Department of Labor. Most of the revenue will support additional and improved services at the three targeted agencies (DSS, DDS and OEC). To model the public benefits of the fee revenue accruing to the state, we assume state government spending increases by the fee amount in the category of state and local government employment and spending in the non-education area. This is one of two categories in the IMPLAN model for such spending (the other is educational spending). In input-output models such as IMPLAN, government's value added is primarily the cost of

Table 1: Economic and Fiscal Impacts of SB 1044

Scenario	Total Net Employment Impact	Net Value Added Impact	Net State and Local Tax Impact ⁹	Net Revenue to the State
Firms Bear Full Fee Burden	532	\$92,448,706	(\$4,731,900)	\$183,860,270
Firms & Households Share Fee Burden Equally	960	\$111,509,913	(\$1,799,500)	\$186,792,670
Households Bear Full Fee Burden	1,388	\$130,571,119	\$1,132,901	\$189,725,071

Source: IMPLAN models and authors' calculations

labor to deliver public services that in this case will manifest in increased employment in the Departments of Labor, Social Services and Developmental Services and the Office of Early Childhood (about 1,800 new employees overall). We take this approach not only because of the limitations in the economic model, but further, we do not know how the advisory board will apportion the fee revenue and what the three agencies will do with their shares. There is a range of opportunities for improving the well-being of low-wage working families; once these are identified it will be possible to estimate more precise public benefits.

Endnotes:

¹ See the Issue Brief, “The Economic and Fiscal Impact of Low-Wage Work in Connecticut,” at <http://cahs.org/wp-content/uploads/2015/04/issueBriefCT6.pdf> and references therein.

² Nonprofit firms and government employers are exempt under the Fair Labor Standards Act from minimum wage laws; however, SB 1044 may pose an interesting case in interpreting the FLSA.

³ We use the IMPLAN economic model.

⁴ This number was estimated using American Community Survey (Public-Use Microdata System) and data from the Connecticut Department of Labor on the distribution of firm sizes by industry. The detailed methodology is available on request at stanley.mcmillen (at) uconn.edu and will be included in the forthcoming report.

⁵ See <http://www.cga.ct.gov/2015/fn/2015SB-01044-R000344-FN.htm>

⁶ Sales from County Business Patterns 2013 and the Economic Census 2007. Final demand estimates are from the IMPLAN study area data.

⁷ The first scenario assumes perfectly inelastic demand and finite supply elasticity in each industry’s market. The second assumes equal demand and supply elasticities, while the third assumes perfectly inelastic supply and finite demand elasticity.

⁸ Taxes on production and imports (TOPI) decline more than the increase in household taxes. TOPI consist of tax liabilities, such as general sales and property taxes that are chargeable to business expense in the calculation of profit-type incomes. Also included are special assessments. TOPI is comprised of state and local taxes—primarily non-personal property taxes, licenses, and sales and gross receipts taxes—and federal excise taxes on goods and services. See http://www.bea.gov/faq/index.cfm?faq_id=93

⁹ This column tabulates the impact on income, sales and property taxes on households and businesses.

About the University of Connecticut School of Social Work

The University of Connecticut School of Social Work builds knowledge to improve social work practice, while maintaining a strong public service mission. Situated on the University of Connecticut Greater Hartford campus, the school offers access to a major urban center, ethnically and economically diverse populations, hundreds of human service agencies, and state government offices. MSW education has been its signature program since 1946, with over 6,800 alumni. The school offers a Ph.D. in social work and provides extensive non-degree programs. The school has a clear and strong commitment to promoting social and economic justice and improving well-being for the citizens of the state of Connecticut, as well as individuals, families and communities nationally and internationally.



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About the Authors

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