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More than the Minimum in Maryland

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The increase in Maryland's minimum wage to $10.10 by 2018, approved by the Maryland General Assembly this spring, is a societal plus but could be a negative for some small-to-medium sized businesses in the Free State.

The hike in hourly wages will be made gradually – edging up to $8 an hour on Jan. 1, 2015, and $8.25 on July 1, 2015. After that, it goes up in 50 cent increments in 2016 and 2017, and hits $10.10 on July 1, 2018.

Nineteen states – and the neighboring District of Columbia – have minimum wages that are higher than $7.25 per hour. D.C.'s minimum wage is currently $8.25 per hour.

Proponents of a higher minimum wage say that the way a society treats the less fortunate is a barometer of the quality of that society. This is a public policy theme that was first voiced by President Lyndon B. Johnson in the mid-1960s when he championed the legislation that created his Great Society.

Advocates of the minimum wage increase also argue that it is an incentive to get more people into the workforce. The way they see it, more people are likely to get off the couch for $10 an hour versus $7 an hour.

But will the higher minimum wage make employees of some Maryland businesses too expensive to deliver products and services to the local marketplace? That's a possibility that has me worried. When costs go up, without the ability to raise revenue, this could have a dramatic effect on business profitability. And when business owners don't make as much in profit, they have two choices: close or move to another state where conditions are more favorable to business.

When the competition is only a few blocks away, lower costs of doing business can have a significant impact. For example, I have a friend who owns a day labor firm that operates on the border of Maryland and D.C. When the Maryland minimum wage hits $10.10 in the summer of 2018, all he will need to do is move his business two blocks into the District to have lower labor costs and bid more competitively on projects that would cost a Maryland-based business 10 percent to 15 percent more.

For landscaping companies and auto repair shops, a higher minimum wage is not necessarily the main issue. A bigger problem that could affect the ability of such companies to attract workers, and ultimately determine whether they stay in Maryland, is the overall size of the welfare benefit package that includes unemployment benefits.

Currently, Maryland ranks 10th in welfare benefit packages. According to a recent study by the Cato Institute, a single mother in Maryland with two children receives $17.15 per hour in total welfare benefits compared to the minimum wage of $7.15 per hour. The study concluded that the high value of welfare benefits might create a disincentive for recipients to leave welfare for work while providing an incentive to drop out of the labor force.

Meanwhile, some economic policy experts argue that raising the minimum wage doesn't really affect the poverty issue. According to the American Action Forum, a conservative policy think tank, current statistics show that only 21

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percent of the people earning the minimum wage are below the poverty line.

What's the solution? One possibility, advocated in a recent AAF white paper, is to increase the earned income tax credit. The EITC, first enacted under the Ford Administration in 1975, is an income subsidy provided through the tax code specifically targeted to low-income working families. The value of the credit received is a fixed percentage of family earnings, as earnings increase, so does the credit at a constant rate determined by the number of children. The credit hits a maximum value also determined by the number of children.

According to the AAF white paper, "The EITC better targets families in poverty and incentivizes people to work, the key to moving out of poverty. Those without jobs are four times more likely to be in poverty than those who are employed."

What's the bottom line for small businesses in Maryland if neighboring states don't raise the minimum wage also? It is unavoidable that profit margins of certain Maryland businesses will shrink due to their location. These companies will have to determine how much price elasticity there is in the marketplace. For example, if a lawn care company raises its price by 10 percent to offset a 20 percent increase in labor costs, how many people will decide to cut their own grass?

In the long run, how many small businesses will have to close down or leave the state because of the increased cost of doing business due to the higher minimum wage coupled with the work disincentive created by the state's generous welfare benefits package? Only time will tell.

From a societal standpoint, there is no doubt that a fair minimum wage is essential to ensure equitable treatment for all. But from a business standpoint, increasing the earned income tax credit might be a better way to incentivize low-income people to join the workforce. Holding the line on future increases in unemployment and welfare benefits could also help in this regard. And when it comes to offsetting higher labor costs in Maryland that will be created by a higher minimum wage, probably the best way would be to lower the state's business taxes.

Capitalism is a good thing. Making capitalism more viable ultimately helps all of our social engines run smoothly. Do Maryland lawmakers need to have a better appreciation of this reality? I think so.