



Bell Policy Center

Indexing, inflation and the minimum wage

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Executive summary

Amendment 42 on the November 2006 ballot will increase Colorado's minimum wage from \$5.15 per hour to \$6.85 per hour and adjust it annually based on the consumer price index used for Colorado.

Linking or indexing the minimum wage to inflation ensures that it keeps pace with the cost of living and protects the earnings of low-wage workers from losing ground to inflation.

The minimum wage has not been increased since 1997 and has lost about 25 percent of its purchasing power to inflation during that time. The wage is at its lowest value relative to prices in 50 years, and at its lowest value relative to average wages in the economy in 57 years — since 1949.

From 1914 through 2005, inflation in the United States averaged 3.4 percent per year. During the past 20 years, inflation nationally averaged 3.0 percent per year, ranging from a high of 5.4 percent in 1990 to lows of 1.6 percent in 1998 and 2002. In Colorado over the same period, inflation averaged 2.9 percent per year, ranging from a high of 4.7 percent in 2001 to a low of 0.1 percent in 2004.

Many people realize that inflation increases most years, and some express concern that indexing the minimum wage to inflation will result in a wage that businesses cannot afford to pay. However, few people realize that average wages in the economy generally increase faster than inflation. These are the wages paid to the 94 to 97 percent of the workers who would not be affected by increases in the minimum wage.¹

In 1985, the average Colorado wage was \$9.34 per hour and the minimum wage was \$3.35. By 2005, the average wage in Colorado grew to \$20 per hour.

If the state's minimum wage had been indexed to inflation during this period, it would have grown to \$5.96. While indexing the Colorado minimum wage to inflation would have allowed it to keep pace with the cost of living, it still would have grown more slowly compared to higher wages in the economy.

In periods of low inflation, average wages grow faster than inflation and minimum wages indexed to inflation fall behind. During times of high inflation, minimum wages indexed to inflation would grow faster than average wages and the gap between the two would narrow.

In the inflationary decade of 1973-82, inflation increased 140 percent. By comparison, average wages in the national economy increased 90 percent over the same period. In a comparable inflationary period, it is possible a minimum wage indexed to inflation would increase in value more than average wages.

The 1973-82 era was unusual, and economists do not foresee that type of rampant inflation for the coming years. Economic projections for the next five years call for inflation to increase by 3.2 to 3.5 percent a year.²

Given these projections, a new state minimum wage of \$6.85 adopted in 2007 would grow by 23 cents an hour through 2010 and by 25 cents an hour in 2011, to reach \$7.79 an hour. This increase merely keeps the purchasing power of the minimum wage the same as in 2007.

This issue brief reviews historical data on inflation in the United States and Colorado, compares increases in inflation with growth in average wages in the national and Colorado economies, and describes how indexing to inflation affects the value of the minimum wage.