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# The Federal Minimum Wage: In Brief

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January 17, 2014

**Congressional Research Service**

7-5700

[www.crs.gov](http://www.crs.gov)

R43089

## Summary

The Fair Labor Standards Act (FLSA), enacted in 1938, is the federal legislation that establishes the minimum hourly wage that must be paid to all covered workers. The minimum wage provisions of the FLSA have been amended numerous times since 1938, typically for the purpose of expanding coverage or raising the wage rate. Since its establishment, the minimum wage rate has been raised 22 separate times. The most recent change was enacted in 2007 (P.L. 110-28), which increased the minimum wage to its current level of \$7.25 per hour.

In addition to setting the federal minimum wage rate, the FLSA provides for several exemptions and subminimum wage categories for certain classes of workers and types of work. Even with these exemptions, the FLSA minimum wage provisions still cover the vast majority of the workforce. Despite this broad coverage, however, the minimum wage directly affects a relatively small portion of the workforce. Currently, there are approximately 3.6 million workers, or 4.7% of all hourly paid workers, whose wages are at or below the federal minimum wage of \$7.25 per hour. Approximately three-quarters of minimum wage workers are age 20 or older and nearly two-thirds work part time.

Proponents of increasing the federal minimum wage argue that it may increase earnings for lower income workers, lead to reduced turnover, and increase aggregate demand by providing greater purchasing power for workers receiving a pay increase. Opponents of increasing the federal minimum wage argue that it may result in reduced employment or reduced hours, lead to a general price increase, and reduce profits of firms paying a higher minimum wage.

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# The Federal Minimum Wage

The Fair Labor Standards Act (FLSA), enacted in 1938, is the federal legislation that establishes the general minimum wage that must be paid to all covered workers.<sup>1</sup> A full discussion of the coverage of the minimum wage is beyond the scope of this report, which provides only a broad overview of the topic. In general, the FLSA mandates broad general minimum wage coverage. It also specifies certain categories of workers who are not covered by FLSA wage standards, such as workers with disabilities or certain youth workers. The act was enacted because its provisions were meant to both protect workers and stimulate the economy. The FLSA also created the Wage and Hour Division (WHD), within the Department of Labor (DOL), to administer and enforce the act.

In 1938, the FLSA established a minimum wage of \$0.25 per hour. The minimum wage provisions of the FLSA have been amended numerous times since then, typically for the purpose of expanding coverage or raising the wage rate. Since its establishment, the minimum wage rate has been raised 22 separate times. The most recent change was enacted in 2007 (P.L. 110-28), which increased the minimum wage from \$5.15 per hour to its current rate of \$7.25 per hour in three steps. For employees working in states with a minimum wage different from that of the federal minimum wage, the employee is entitled to the higher wage of the two.

## FLSA Minimum Wage Coverage

The FLSA extends minimum wage coverage to individuals under two types of coverage—“enterprise coverage” and “individual coverage.”<sup>2</sup> An individual is covered if they meet the criteria for either category. Around 130 million workers, or 84% of the labor force, are covered by the FLSA.<sup>3</sup>

### Enterprise Coverage

The first category of coverage is at the business or enterprise level. To be covered, an enterprise must have at least two employees and must have annual sales or “business done” of at least \$500,000. Annual sales or business done includes all business activities that can be measured in dollars. Thus, for example, retailers are covered by the FLSA if their annual sales are at least \$500,000.<sup>4</sup> In non-sales cases, such as enterprises engaged in leasing property, gross amounts paid by tenants for property rental will be considered “business done” for purposes of determining enterprise coverage.

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<sup>1</sup> In addition, the FLSA provides for overtime pay and child labor protections. The scope of this report is only on the minimum wage provisions. For a broader overview of the FLSA, see CRS Report R42713, *The Fair Labor Standards Act (FLSA): An Overview*, by Gerald Mayer, Benjamin Collins, and David H. Bradley.

<sup>2</sup> 29 U.S.C. §206(a).

<sup>3</sup> U.S. Department of Labor, Wage and Hour Division, *Coverage Under the Fair Labor Standards Act (FLSA)*, Fact Sheet #14, Washington, DC, July 2009, <http://www.dol.gov/whd/regs/compliance/whdfs14.pdf>. Because some individuals are exempt from the minimum wage provisions of the FLSA, the number of workers covered by the minimum wage provisions is presumably lower.

<sup>4</sup> The \$500,000 threshold refers to the annual gross volume of sales. It is not a measure of net revenue or profits.

In addition, regardless of the dollar volume of business, the FLSA applies to hospitals or other institutions primarily providing medical or nursing care for residents; schools (preschool through institutions of higher education); and federal, state, and local governments.

## Individual Coverage

The second category of coverage is at the individual level. Although an enterprise may not be subject to minimum wage requirements if it has less than \$500,000 in annual sales or business done, employees of the enterprise may be covered if they are individually engaged in interstate commerce or in the production of goods for interstate commerce. The definition of interstate commerce is fairly broad. To be engaged in “interstate commerce,” employees must produce goods (or have indirect input to the production of those goods) that will be shipped out of the state of production, travel to other states for work, make phone calls or send emails to persons in other states, handle records that are involved in interstate transactions, or provide services to buildings (e.g., janitorial work) in which goods are produced for shipment outside of the state.<sup>5</sup>

## Exemptions and Subminimum Wages

The FLSA covers most, but not all, private and public sector employees.<sup>6</sup> Certain employers and employees are exempt from all or parts of the FLSA minimum wage provisions, either through the individual or enterprise coverage or through specific exemptions included in the act. In addition, the FLSA provides for the payment of subminimum wages (i.e., less than the statutory rate of \$7.25 per hour) for certain classes of workers.

## Excluded from FLSA Minimum Wage Coverage

The FLSA statutorily exempts various workers from FLSA minimum wage coverage. Some of the exemptions are for a class of workers (e.g., executive, administrative, and professional employees), while others are more narrowly targeted to workers performing specific tasks (e.g., workers employed on a casual basis to provide babysitting services).

The list below is not exhaustive but is intended to provide examples of workers who are not covered by the minimum wage requirements of the FLSA:<sup>7</sup>

- bona fide executive, administrative, and professional employees;<sup>8</sup>

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<sup>5</sup> U.S. Department of Labor, *Coverage Under the Fair Labor Standards Act*, available at <http://www.dol.gov/whd/regs/compliance/whdfs14.pdf>. (Hereinafter cited as DOL, *Coverage Under the Fair Labor Standards Act*.) These examples are not exhaustive but are meant to illustrate the relatively broad range of activities comprising “interstate commerce.”

<sup>6</sup> According to the WHD, “more than 130 million workers” are covered by the FLSA. Out of a total civilian labor force of about 155 million, this implies that about 84% of the workforce is covered.

<sup>7</sup> Most exemptions for individuals are in 29 U.S.C. §203(e), 29 U.S.C. §213(a), and 29 U.S.C. §213(d). The list here should not be considered exhaustive as there are various job duties, earnings, and employer characteristic requirements that further define the general exemptions listed here.

<sup>8</sup> The term “bona fide” indicates that job titles alone do not determine exempt status. Rather, employees falling under this exemption must meet criteria related to job duties and pay. See U.S. Department of Labor, Wage and Hour Division, *Exemption for Executive, Administrative, Professional, Computer & Outside Sales Employees Under the Fair Labor Standards Act (FLSA)*, Fact Sheet #17A, Washington, DC, July 2008, [http://www.dol.gov/whd/regs/compliance/fairpay/fs17a\\_overview.pdf](http://www.dol.gov/whd/regs/compliance/fairpay/fs17a_overview.pdf).

- individuals employed by certain establishments operating only part of the year (e.g., seasonal amusement parks, organized summer camps);
- individuals who are elected to state or local government offices and members of their staffs, policymaking appointees of elected officeholders of state or local governments, and employees of legislative bodies of state or local governments;
- employees who are immediate family members of an employer engaged in agriculture;
- individuals who volunteer their services to a private, nonprofit food bank and who receive groceries from the food bank;
- agricultural workers meeting certain hours and job duties requirements;
- individuals employed in the publication of small circulation newspapers;
- domestic service workers employed on a casual basis to provide babysitting;
- individuals employed to deliver newspapers; and
- certain employees in computer-related occupations.

## Subminimum Wages

The FLSA also allows the payment of subminimum wages for certain classes of workers, including the following:

- **Youth.**<sup>9</sup> Employers may pay a minimum wage of \$4.25 per hour to individuals under the age of 20 for the first 90 days of employment.
- **Learners.**<sup>10</sup> Employers may apply for special certificates from the Wage and Hour Division of DOL that allow them to pay students who are receiving instruction in an accredited school and are employed part-time as part of a vocational training program a wage at least 75% of the federal minimum wage (\$5.44 at the current minimum wage).
- **Full-Time Students.**<sup>11</sup> Employers may apply for special certificates from the Wage and Hour Division of DOL that allow them to pay full-time students who are employed in retail or service establishments, an agricultural occupation, or an institution of higher education a wage at least 85% of the federal minimum wage (\$6.16 at the current minimum wage).
- **Individuals with Disabilities.**<sup>12</sup> Employers may apply for special certificates from the Wage and Hour Division of DOL that allow them to pay wages lower than the otherwise applicable federal minimum to persons “whose earning or productive capacity is impaired by age, physical or mental deficiency, or injury.” As elaborated in regulations, disabilities that may affect productive capacity include, but are not limited to, blindness, mental illness, mental retardation,

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<sup>9</sup> 29 U.S.C. §206(g).

<sup>10</sup> 29 U.S.C. §214(a).

<sup>11</sup> 29 U.S.C. §214(b).

<sup>12</sup> 29 U.S.C. §214(c).

cerebral palsy, alcoholism, and drug addiction. There is no statutory minimum wage required under this provision of the FLSA, but pay is to be broadly commensurate with pay to comparable non-disabled workers and related to the individual's productivity.<sup>13</sup>

- **Tipped Workers.**<sup>14</sup> Under Section 203(m) of the FLSA, a “tipped employee”—a worker who “customarily and regularly receives more than \$30 a month in tips”—may have his or her cash wage from an employer reduced to \$2.13 per hour, as long as the combination of tips and cash wage from the employer equals the federal minimum wage. An employer may count against his or her liability for the required payment of the full federal minimum wage the amount an employee earns in tips. The value of tips that an employer may count against their payment of the full minimum wage is known as the “tip credit.” Under the current federal minimum wage and the current required minimum employer cash wage, the maximum tip credit is \$5.12 per hour (i.e., \$7.25 minus \$2.13). Thus, all workers covered under the tip credit provision of the FLSA are guaranteed the federal minimum wage.

## Characteristics of Minimum Wage Workers

The most recent data available indicate that there are approximately 3.6 million workers, or 4.7% of all hourly paid workers, whose wages are at or below the federal minimum wage of \$7.25 per hour. Of these 3.6 million workers, approximately 1.6 million earn the federal minimum wage of \$7.25 per hour and the other 2 million earn below the federal minimum wage. As the Bureau of Labor Statistics (BLS) notes, the large number of individuals earning less than the statutory minimum wage does not necessarily indicate violations of the FLSA but may reflect exemptions or misreporting.<sup>15</sup>

Of the estimated 3.6 million workers earning at or below the minimum wage,

- about a quarter (24.1%) are teenagers (ages 16-19),
- nearly two-thirds (64.4%) are female,
- just over one-third (36%) are full-time workers (35 or more hours per week),
- more than 40% work in “food preparation and serving related occupations,”

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<sup>13</sup> For details on the process for determining wages under Section 14(c), see U.S. Department of Labor, Wage and Hour Division, *Prevailing Wages and Commensurate Wages under Section 14(c) of the Fair Labor Standards Act (FLSA)*, Fact Sheet #39B, Washington, DC, May 2009, <http://www.dol.gov/whd/regs/compliance/whdfs39b.pdf>.

<sup>14</sup> 29 U.S.C. §203(m).

<sup>15</sup> Bureau of Labor Statistics (BLS), U.S. Department of Labor, *Characteristics of Minimum Wage Workers: 2012*, Washington, DC, February 26, 2013, <http://www.bls.gov/cps/minwage2012.pdf>. BLS produces an annual report on minimum wage workers using data from the Current Population Survey (CPS), which is a monthly household survey used to collect economic and demographic information on the population. The CPS does not ask respondents directly if they earn the minimum wage. Rather the estimate of workers at or below the federal minimum wage is derived from reported earnings on a person's sole (or principal) job. As BLS notes, because the estimates are based on workers paid at hourly rates, with salaried and non-hourly workers excluded, “the actual number of workers with earnings at or below the prevailing minimum wage is undoubtedly understated.”

- just over 15% work in “sales and related occupations,” and
- nearly three-quarters (72.2%) have at least a high school degree; overall, 8.0% have a bachelor’s degree or higher.

## State Minimum Wages

States may also choose to set labor standards that are different from federal statutes. The FLSA establishes that if states enact minimum wage, overtime, or child labor laws more protective of employees than those provided in the FLSA, the state law applies. In the case of minimum wages, this means that if an individual is covered by the FLSA in a state with a higher state minimum wage, the individual is entitled to receive the higher state minimum wage. On the other hand, some states have set minimum wages lower than the FLSA minimum. In those cases, an FLSA-covered worker would receive the FLSA minimum wage and not the lower state minimum wage.

Currently, 21 states and the District of Columbia have minimum wage rates above the federal rate of \$7.25 per hour. These rates range from \$7.40 per hour in Michigan to \$9.32 in Washington State. Four states have minimum wage rates below the federal rate and five have no minimum wage requirement. The remaining 20 states have minimum wage rates equal to the federal rate.<sup>16</sup> In the states with no minimum wage requirements or wages lower than the federal minimum wage, only individuals who are not covered by the FLSA are subject to those lower rates.

## Arguments For and Against Raising the Minimum Wage

The literature on the effects of the minimum wage is vast and represents one of the more well-studied issues in labor economics. As such, this topic has resulted in hundreds of academic and non-academic publications. It is beyond the scope of this section to summarize or synthesize this literature. Broadly speaking, there is not universal consensus on the causal relationship between changes in minimum wage and other economic outcomes. This section presents a brief summary of the primary arguments that proponents and opponents make regarding minimum wage increases.

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<sup>16</sup> U.S. Department of Labor, Wage and Hour Division, *Minimum Wage Laws in the States*, <http://www.dol.gov/whd/minwage/america.htm>.



## Arguments For Increasing the Minimum Wage<sup>17</sup>

### Increases Earnings

Proponents of an increase in the minimum wage often assert that raising wages can be a component in reducing poverty for individuals and families and a direct way to increase earnings for lower-income workers. Assuming the minimum wage earner does not suffer a loss of employment, hours, or other wage supplements as a result of the increase, then an increased minimum wage should close the gap between earnings and the poverty line. For example, a single parent with two children who works full-time, year-round at the current minimum wage has earnings of about 76% of the poverty line. An increase in the minimum wage to \$9 per hour would raise that family's earnings to about 94% of the poverty line.<sup>18</sup>

### Increases Aggregate Demand

Proponents of minimum wage increases also argue that additional income for individuals will result in increased aggregate demand in the economy. Adult minimum wage households have a higher marginal propensity to spend additional income than higher-income households. Therefore, to the extent that minimum wage increases raise the income of adult minimum wage households, a minimum wage increase could have a stimulative effect on the economy.

### Reduces Inequality

Proponents of an increase in the minimum wage argue that it could help reduce earnings inequality by setting a higher floor at the lower end of the wage scale. At the level of an individual business, wage compression might occur if the minimum wage increases at the low end of the pay scale were offset by freezes or reductions in pay at higher levels of pay. That is, the spread between the lowest earners and the highest earners at a business might narrow if the business adjusted to higher pay for minimum wage earners by keeping flat or reducing pay for higher earners. Economy-wide, the size of the gap between low-wage earners and middle and high earners might decrease depending on how widely wage compression was used as a channel of adjustment to minimum wage increases.

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<sup>17</sup> For examples of arguments in favor of increasing the federal minimum wage, see David Cooper and Doug Hall, *Raising the Federal Minimum Wage to \$10.10 Would Give Working Families, and the Overall Economy, A Much-Needed Boost*, Economic Policy Institute, Briefing Paper #357, Washington, DC, March 13, 2013, <http://www.epi.org/files/2013/bp357--federal-minimum-wage-increase.pdf> and Christian E. Weller and Nick Bunker, *A Higher Minimum Wage Will Not Hurt U.S. Businesses*, Center for American Progress, Washington, DC, February 15, 2013, <http://www.americanprogress.org/issues/economy/news/2013/02/15/53603/a-higher-minimum-wage-will-not-hurt-u-s-businesses/>.

<sup>18</sup> These figures, produced by CRS, are based on estimated 2014 poverty thresholds. For a family of three the poverty threshold is \$19,820. At the current minimum wage of \$7.25 per hour, a full-time, year-round worker would earn \$15,080, or 76% of this threshold. At a minimum wage of \$9.00 per hour, a full-time, year-round worker would earn \$18,720, or 94% of this threshold.

## **Reduces Employee Turnover**

A higher wage may lead workers to choose to stay in their jobs longer than they otherwise would have under a lower wage. Because high turnover is costly to businesses, proponents of minimum wage increases argue that an increase in the minimum wage may be offset by lower turnover costs.

## **Arguments Against Increasing the Minimum Wage<sup>19</sup>**

### **Reduces Employment**

Much of the popular discussion about the effects of a minimum wage increase focuses only on one channel of adjustment—employment. In particular, opponents of a minimum wage or of minimum wage increases assert that increases in the minimum wage will result in increased unemployment, either broadly or for particular subpopulations of the labor market (e.g., youth, less skilled or experienced workers), or a reduction in hours worked. In a standard competitive model of the labor market, the introduction of or increase in the minimum wage (a price increase) results in employment losses (demand decrease).

### **Does Not Reduce Poverty**

Because the minimum wage is not targeted to workers in low-income households, it is possible that the minimum wage does not reduce poverty to the extent a targeted policy might (e.g., tax credit). The minimum wage is a relatively blunt anti-poverty policy as it may raise wages for people not in poverty such as suburban teenagers who live in a middle- or high-income household.

### **Increases Prices**

Another way minimum wage increases might be absorbed is through changes in prices. Specifically, employers facing a higher mandated minimum wage might choose, if possible, to pass on the extra costs of labor to the consumers through higher prices. If minimum wage increases result in an increase in the aggregate price level, then the inflationary effects would erode some of the purchasing power of both those receiving raises and everyone else in the economy.

### **Reduces Profits**

A decrease in profits could be another means of adjustment to an increase in the minimum wage. The ability of any given business to lower profits to pay for mandated increases depends on the profit margins of that firm.

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<sup>19</sup> For examples of arguments against increasing the federal minimum wage, see Mark Wilson, *The Negative Effects of Minimum Wage Laws*, Cato Institute, Washington, DC, September 2012, <http://www.downsizinggovernment.org/sites/downsizinggovernment.org/files/pdf/negative-effects-minimum-wage-laws.pdf> and James Sherk, *Who Earns the Minimum Wage? Suburban Teenagers, Not Single Parents*, The Heritage Foundation, Issue Brief No. 3866, Washington, DC, March 1, 2013, [http://thf\\_media.s3.amazonaws.com/2013/pdf/ib3866.pdf](http://thf_media.s3.amazonaws.com/2013/pdf/ib3866.pdf).

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