

How Living Wage Laws Affect Low-Wage Workers and Low-Income Families

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Foreword

America's cities have traditionally pursued new development by providing a variety of economic incentives or subsidies to developers, investors, and landowners. Proponents of these subsidies argue that jobs and taxes stemming from the new growth more than compensate for the subsidy. However, in recent years, some city officials (influenced by labor and community organizations) have moved beyond the subject of job growth and have expressed concern about the adequacy of wages for those already employed.

The challenges facing a working-poor family in urban America are well documented, including housing availability and costs, health care, child care, and transportation. Thus, the concern in many cases has begun to focus on the quality of life among those at the lower end of the income distribution rather than on creating more jobs. National and state minimum wage laws are often viewed as too modest in their compensation, and thus various voices have called for a "living wage" that reflects the reality of living and working in today's urban centers.

In this study, Professor David Neumark, a visiting fellow at PPIC in 2001, takes a close look at living wage ordinances across the United States, assessing their effects on wage and employment levels of the urban poor and on urban poverty. Nationwide, some 40 cities and a number of other jurisdictions have passed living wage ordinances. These ordinances mandate that certain businesses, generally those under contract with the city, pay employees a wage high enough to lift their families out of poverty. Indeed, among the cities studied, Neumark finds that living wages have a substantial effect on the wages of workers at the bottom of the scale—and the broader the scope of coverage, the more likely lower-wage workers will be positively affected.

However, as we might expect, he finds a tradeoff between wages and employment. Although living wage laws raise the wages of the urban poor who hold jobs, they also appear to reduce employment levels at the

low end of the wage distribution. Once again, targeting subsidy programs is the toughest part of program design. The good news is that Neumark finds that despite individual worker differences, living wages reduce the likelihood that families live in poverty.

One surprising element in this analysis is that Neumark finds sizable wage gains among unionized municipal workers in cities that implement living wage ordinances covering city contractors. He suggests that living wage laws may reduce the incentives for cities to contract out work that would otherwise be done by municipal employees, thus increasing the bargaining power of municipal unions and leading to higher wages. Certainly this would help explain why labor unions—especially those representing municipal workers—are particularly active in the movement to pass living wage ordinances.

It should be noted that although this study finds that living wages may provide some assistance to the urban poor, it does not compare the effectiveness of living wages to other poverty-reduction policies, such as the earned income tax credit, and Neumark observes that policymakers should weigh such alternatives when considering whether to implement a living wage ordinance.

It should also be noted that the summary of this report is written for a lay audience and read alone is sufficient to understand the study's major findings. The body of the report (in particular Chapters 5 through 8) is more technical and is designed to provide the policy specialist and researcher with a detailed description of the methodology and analysis involved in the study. Together they provide an incisive, first-time empirical assessment of the mechanisms and effects of living wage ordinances.

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Summary

Since December 1994, many cities in the United States have passed living wage ordinances. These ordinances typically mandate that businesses under contract with the city, or in some cases receiving assistance from the city (such as subsidies, grants, or tax abatements), must pay their workers a wage sufficient to support a family financially. Baltimore was the first city to pass such legislation, and nearly 40 cities and a number of other jurisdictions have followed suit. Although living wage laws have become popular nationally, California has to some extent been at the forefront of the living wage movement. Four major California cities (Los Angeles, Oakland, San Francisco, and San Jose) have living wage laws on the books, as do six smaller cities (Berkeley, Hayward, Pasadena, San Fernando, Santa Cruz, and West Hollywood). In addition, campaigns to pass living wages are ongoing in other California cities.

The living wage laws in these California cities help to highlight the prominent features of living wage laws nationwide. First, all living wage ordinances feature a minimum wage floor that is higher—and often much higher—than the traditional minimum wages set by state and federal legislation. For example, the current minimum wage in California is \$5.75, but living wages range from a low of \$7.25 in Pasadena and San Fernando, to \$7.69 in Los Angeles, to \$9.00 in San Francisco, and to a high of \$11.00 in Santa Cruz. Second, living wage laws frequently link the wage floor to a poverty threshold, for example, requiring a wage that would raise a family of four with one full-time worker to the poverty level. Third, coverage by living wage ordinances is far from universal. The most common coverage—and also the most narrow—is restricted to companies under contract with the city. Some living wage laws also impose the wage on companies receiving business assistance from the city. The least common coverage is that imposed by cities on themselves to cover city employees. Regardless, this narrower

coverage contrasts with minimum wage laws, which cover nearly all workers. Thus, living wage laws impose high wage floors, have an antipoverty objective that is often reflected in the choice of the wage floor, and often apply to what may constitute a relatively narrow group of workers.

To date, there has been no systematic analysis of the actual effects of living wages on the expected beneficiaries—low-wage workers and lower-income families. Given the fact that a large number of cities have passed living wage laws recently and that campaigns for such laws are under way in many other cities, this is an opportune time to analyze the effects of these laws.

The goal of this monograph is to present such an analysis. Although living wage laws have been adopted in many California cities, the empirical research in this monograph relies on information from living wage laws across the United States, although some attention is given to whether these results also apply to California specifically. The monograph begins by providing some necessary background, in particular (1) describing the evolution of living wage laws in the United States, (2) discussing what economic theory predicts about the effects of living wage laws, and (3) reviewing what we know about the effects of living wage laws from past research on living wages and minimum wages.

The monograph then turns to new research that addresses a broad-ranging set of questions intended to make a significant start on developing a fuller understanding of living wages. In particular, it aims to provide evidence relevant to (1) understanding how living wage laws work and how policy analysts can study their effects, (2) assessing whether living wages achieve their primary policy goal, and (3) understanding the incentives of actors in the economic and political arena to push for living wage laws, and in so doing, asking whether workers other than the intended beneficiaries gain from living wages. Specifically, the following questions are addressed:

- Do living wage laws actually raise wages for at least some low-wage workers? Are living wage laws sufficiently broad and enforced strongly enough to have effects that can be detected in the data available to policy analysts?

- Do living wage laws achieve their stated policy objective of improving economic outcomes for low-wage workers and low-income families? Are wage gains for low-wage workers offset by reductions in employment or in hours worked? Do living wage laws reduce urban poverty?
- Given the stated antipoverty goal of living wage campaigns, why do the laws frequently narrowly restrict coverage to city contractors, rather than imposing wage floors for broad groups of workers? Could one contributing factor be that living wage laws when applied to city contractors reduce the incentives of city governments to privatize, hence strengthening the hand of municipal unions and bringing wage gains to unionized municipal workers, so that there is a potentially powerful constituency for living wage laws that may fall short of the breadth needed to have an effect on poverty?

The goal of the empirical research is to reveal the causal effects of living wage laws. But these (and other) laws are not adopted in a vacuum. Thus, the research strategy must try to sort out causal effects from relationships between outcomes and living wages that arise because of where and when living wage laws are adopted. For example, if living wage laws are adopted where labor markets for low-skill individuals are strong, or where state-level policies encourage work among low-skill individuals, the effects of living wage laws may appear to be more beneficial than they in fact are. As a consequence, the empirical analysis of living wage laws employs a variety of strategies meant to assess whether there are alternative explanations for the relationships found between living wages, on the one hand, and wages, employment, and poverty, on the other. For example, the basic strategy relies on comparing changes in outcomes in cities that did and did not pass living wage laws, to avoid the possibility that living wage laws were adopted in cities in which low-skill individuals on average fare better (or worse). And embellishments of this strategy allow for living wage and non-living wage cities to have different underlying trends in outcomes for low-skill workers, inferring a causal effect only from a break in the trend. Based on the full set of empirical analyses, the following principal findings emerge.

First, there are sizable positive effects of living wage ordinances on the wages of low-wage workers in the cities in which these ordinances are enacted. In particular, the estimates indicate that a 50 percent increase in the living wage (over the minimum wage) would, over the course of a year, raise average wages for workers in the bottom tenth of the wage distribution by 3.5 percent. As an example, for workers otherwise earning the minimum wage in California of \$5.75 (in 2000), this represents an average raise of 20 cents per hour. This may appear to be a small increase, but it is an average wage increase experienced by low-wage workers, whereas the actual effect would most likely be a much larger increase concentrated on fewer workers.

In fact, this average increase is larger than would be expected based on the limited coverage of city contractors by the most common type of living wage law. The larger wage effects are generated in cities in which coverage of living wage laws is more broad—specifically, in cities that also impose living wages on employers receiving business assistance from the city—and in these cities the effects of living wage laws are about 50 percent larger than the effects cited above. Thus, existing analyses of the likely effects of living wage laws based on narrow coverage and ignoring business assistance provisions may be quite misleading, and it may be appropriate to think of at least some living wage ordinances—in particular those with business assistance provisions—as operating considerably more broadly than wage floors imposed on city contractors.

Second, although living wage laws raise the wages of low-wage workers, they also appear to reduce employment among the affected workers. In particular, the estimates indicate that a 50 percent increase in the living wage would reduce the employment rate for workers in the bottom tenth of the skill distribution (or equivalently, of the predicted wage distribution) by 7 percent, or 2.8 percentage points. Paralleling the results for wages, the evidence of disemployment effects is stronger for broader business assistance living wage laws. These disemployment effects offset to some extent the positive effects of living wage laws on the wages of low-wage workers, pointing to the tradeoff between wages and employment that economic theory would predict. However, the evidence of disemployment effects is statistically weaker.

Third, although economic theory offers some guidance as to expected tradeoffs between employment and higher mandated wage floors, it makes no predictions regarding the effects of living wage laws on family incomes or poverty. The effects ultimately depend on the family incomes of workers who experience wage gains and those whose employment is reduced. The evidence indicates, however, that the broader business assistance living wage ordinances—which raise wages but at the cost of some disemployment—may moderately reduce urban poverty. The best estimates imply that a 50 percent increase in the living wage would reduce the poverty rate by 1.8 percentage points. Such estimates are not inconsistent with the apparently small wage effects noted above. No one is claiming that living wages lift a family from well below the poverty line to well above it. But living wages may help nudge it over the poverty line. A 20 cent increase in hourly wages translates into \$400 of income over the course of the year for a full-time worker. And this is an average effect; the more likely scenario is larger gains concentrated on fewer workers and families. Thus, even coupled with some employment reductions, it is possible that living wages lift a detectable number of families above the poverty line.

Fourth, the evidence points to sizable wage gains for unionized municipal workers when narrow living wage laws covering city contractors are implemented. This evidence is consistent with living wage laws reducing the incentives for cities to contract out work that would otherwise be done by municipal employees, which in turn would be expected to increase the bargaining power of municipal unions and lead to higher wages. As further indirect evidence, labor unions—especially those representing municipal workers—are very active in the movement to pass living wage laws. These findings suggest that a partial explanation of the frequently narrow coverage of living wage laws is that such narrow laws—even if they fail to deliver benefits to low-wage workers or low-income families—benefit unionized municipal workers.

Overall, the combined evidence suggests that the cup is either half full or half empty, depending on one's point of view. Policymakers—whatever their own view of the merits of living wage laws—ought to be encouraged by the finding that living wage laws have their most “direct” intended consequence—raising the wages of low-wage workers.

Economists who put stock in standard economic theory may take some comfort in the finding that wage increases engineered by living wage laws—whatever their other benefits—do lead to some of the predicted tradeoffs in the form of lower employment. Advocates of living wages should be heartened by the results indicating that living wage laws may reduce urban poverty. And finally, those who are skeptical regarding some of the motivations behind unions' support for living wages may find their skepticism reinforced by the evidence that unionized municipal workers reap gains from living wages.

Note, however, that none of these conclusions are necessarily in conflict. Living wage laws can in principle engender some employment losses but, coupled with wage increases and depending on the magnitude and incidence of each of these effects, can also help the poor. And higher-wage unionized municipal workers can gain at the same time that low-income families gain.

A cautious reading of the evidence, then, suggests that, on net, living wages may provide some assistance to the urban poor. This may dispel fears that living wage laws have the unintended effect of increasing urban poverty, but it does not necessarily imply that living wages constitute the best means of helping the urban poor. Policymakers contemplating implementing living wage laws, and policy analysts assessing living wage laws, should give due consideration to comparisons among alternative methods of reducing poverty, such as the Earned Income Tax Credit.

Finally, it is important to emphasize that information on the effects of living wages on low-wage workers and low-income families is only one input—although a crucial one—in providing an overall assessment of living wage policies. Aside from these effects, policymakers should be interested in a number of issues, including the effects of living wages on municipal budgets; on the extent to which higher labor costs are absorbed by contractors or passed through to cities; on taxes, property values, and local economic development; on the provision of city services, stemming from budgetary considerations or the effect of living wages on productivity; on compliance and enforcement; on equity effects (including their effect on women and minorities); and on overall economic welfare. Thus, in and of itself, the evidence presented in this

monograph does not lead to a concrete policy recommendation regarding living wages.

However, by finding some evidence that living wages do have a positive effect on wages at the bottom end of the wage distribution and also may lead to modest poverty reductions (despite some employment loss), the monograph suggests that at least some of the claims of living wage advocates are borne out in the data. This suggests that other potential costs and benefits of living wages should be explored to arrive at an overall assessment of the policy, recognizing that the evaluation may well differ depending on the local economy and the specific law considered. Only with a full accounting of the costs and benefits will policymakers, employer organizations, labor unions, and voters be in a position to make informed judgments regarding the merits of this increasingly popular policy innovation.

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