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Thinking about Local Living Wage Requirements

Abstract

This paper reviews what we currently know about the benefits and costs of different varieties of a "living wage": a local government requirement, now adopted by over 50 local governments, for wages above the federal minimum imposed on employers with some financial link to the local government. The review includes economic theory, empirical research on local labor markets, and empirical research on the living wage. The paper concludes that moderate living wage requirements applied to the local government's own employees, and contractors' and grantees' employees who are funded by the local government, may do more good than harm. Excessive living wages or living wages applied to non-city funded workers are more likely to have negative side-effects. The merits of living wages applied to economic development assistance depend on the local economy's strength and whether this assistance program is used by the city's competitors. In a weak local economy, living wages applied to commonly-used economic development programs may reduce the city's economic growth.

1. INTRODUCTION

"Living wages," now adopted by over 50 local governments, require employers that have some financial interaction with the local government to pay covered employees a living wage that is significantly above the federal or state minimum wage. What are the likely effects of different types of local living wage requirements? Should local governments enact living wage requirements? If so, what design of a living wage policy makes the most sense? These questions are addressed in this paper. The answers presented are based on economic theory and empirical research on local labor markets, as well as empirical research on the effects of living wages.

Local living wage requirements and a national minimum wage have some similarities. Both living wages and minimum wages mandate an increase in some workers' wages. Both policies may reduce some groups' employment. Evaluations must consider each policy's effects on economic efficiency and the income distribution, including effects on the poor and the lower-middle class.

However, local living wage requirements and federal/state minimum wages also have some key differences. I will explore these differences in more detail later, but in short, there are four key differences between local living wages and federal/state minimum wages:

1. Local living wages are much higher than federal or state minimum wages; this increases the odds that living wages may have undesirable employment effects.
2. Local living wage requirements directly affect a much smaller proportion of the workforce than the minimum wage, because living wages only cover employers with financial dealings with the local government, whereas minimum wages cover most employers. The smaller coverage of the living wage implies smaller benefits and costs. However, living wages may also indirectly affect the labor market by signaling employers about public attitudes towards business, wages,

and the disadvantaged. These symbolic effects of living wages may affect the decisions of employers about investment, hiring, and wages. Although the minimum wage may also have symbolic effects, for living wages the symbolic effects may loom larger compared with the modest direct effects.

3. Local living wage requirements are by definition imposed by a local government that, in most cases, has much less clout in the labor market than most state governments and certainly than the federal government. Local living wage requirements must consider effects on the mobility of employers, which is less of an issue at the state level and certainly at the federal level.

4. Local living wage requirements have often been enacted by a strong local political coalition, which goes beyond the labor movement to include neighborhood groups, advocates for racial minorities, and religious groups. In recent years, campaigns for a higher federal or state minimum wage have not attracted such broad support. The political implications of the living wage may be as important as its economic effects.

In section 2, this paper discusses some features of the labor market that influence the likely effects of local living wage requirements. Section 3 analyzes issues in the design of local living wage requirements. Section 4 considers research that has directly observed or estimated the effects of already-enacted living wage requirements. Section 5 analyzes the political implications of living wages. In the concluding section 6, I recommend what local governments should do about the living wage.

2. THE ROLE OF WAGES AND THE ROLE OF EMPLOYERS

Before discussing the benefits and costs of living wage requirements, I will discuss how labor economists view the role of wages and employers in the labor market. The economist's view suggests limits on what government regulation of wages should do.

The rhetoric of living wage campaigns stresses the benefits of living wages in reducing poverty. The implicit assumption is that there are plenty of jobs in the United States (or at least there were plenty of jobs during the late 1990s boom) and that the key barrier to reducing poverty is inadequate wages at entry-level jobs. The moral perspective of the living wage campaign is that it is unjust for many workers to be only able to find jobs that pay poverty-level wages. Many living wage activists view wages as determined by employers. Given employer power over wages, it is immoral for an employer that has the ability to pay living wages to refuse to do so. The government should not financially support an employer that enhances its profits by keeping wages down and thereby increases poverty among workers.

These views reflect some confusion over the role of wages in the labor market. Some important points about wages are the following.

1. <u>Increased wages play some role in reducing poverty, but it is more important to increase full-time, full-year work among the poor. Higher wages are more important in enhancing the living standards of the lower-middle class and working class.</u> Simulations show that increases in the minimum wage reduce poverty but slightly. For example, simulations suggest that the 1997 hike in the minimum wage from $4.25 to $5.15 only reduced the number of persons in poverty by 1 percent (Houseman 1998). Higher wages have little effect on the poor because most of the poor do not work full-time, full-

year. For example, among the non-elderly poor, 43 percent have no workers in the family during a typical year (Bartik 2001, p. 37). Fifty-seven percent of the non-elderly poor have at least one worker, but only in one-third of these families do total work-hours equal or exceed the equivalent of one full-time, full-year worker (2000 annual work-hours) (Bartik 2001, p. 37).

In contrast, increases in full-time, full-year work cause large poverty reductions. For example, simulations suggest that if all non-elderly poor households had the equivalent of one full-time, full-year worker, poverty among these households would be reduced by two-thirds (Sawhill 1999). These simulations include the Earned Income Tax Credit (EITC), which provides low-income households with up to a 40 percent refundable tax credit on their earnings. The EITC pays a crucial role in "making work pay" in reducing poverty.

Higher minimum wages, living wages, union-set wages, or other wage standards play a larger role in increasing the living standards of lower-middle class and working class Americans. For example, simulations suggest that while only 19 percent of the benefits of a higher minimum wage go to workers below the poverty line,[1] 48 percent of the benefits go to working families whose income is between one and three times the poverty line (Burkhauser, Couch, and Wittenberg 1996). The lower-middle class and working class have more full-time, full-year workers who can benefit the most from higher wage standards.

[1]Given that these working poor are only 6 percent of all workers, this group receives proportionally three times as much benefits from a higher minimum wage as the average worker; still, the overall benefit percentage for the working poor is modest.

Improving living standards for the lower-middle class and working class is a worthy objective. However, the rhetoric of living wage campaign stresses benefits for the poor, who are unlikely to be the living wage's main beneficiaries.

2. <u>Wages may not be rigidly determined by worker productivity, but instead allow for employer discretion. However, this discretion may not be much greater than a 30 percent leeway in setting wages</u>. Employers can use their discretionary control over wages to follow a higher- wage strategy. Higher wages can benefit employers by increasing worker productivity. This "efficiency wage" theory states that higher wages may help employers by reducing worker turnover, increasing the ease of hiring new workers, giving workers a greater incentive to work hard to avoid being fired, and improving worker morale. Some support for efficiency wage theory is provided by evidence that similar workers are paid widely different wages in different industries (Katz and Summers 1989) and in different firms within the same industry (Groshen 1991).

In addition, there may be a zone of indeterminancy in wages that allows some room for labor's bargaining power—or government regulations—to bid wages up. As research on internal labor markets shows, firms and workers may invest significantly in the employment relationship (Doeringer and Piore 1971). For some range of wages, either the firm or the worker may be better off in maintaining the employment relationship rather than adjusting to a new job match.

However, there are limits to how big a wage increase for the same worker can be justified by efficiency wages or a zone of wage indeterminancy. Typical wage differentials for similar workers in different industries are 15 to 20 percent (Katz and Summers 1989), and typical wage differentials for similar workers across different firms in the same industry are 10 to 15 percent (Groshen 1991).

Studies of unionization rarely have found wage effects of greater than 30 percent, even when unions are strong (Freeman and Medoff 1984). Employers will do their utmost to resist or evade any wage increase that goes beyond these bounds, and they will usually be successful in doing so, for reasons outlined below.

3. <u>Wages are just one part of the employment package, which also includes credential and skill requirements, fringes and working conditions, and training and career opportunities. Therefore, whether an employer is a "good employer" can not be judged solely or even mainly on the wages paid</u>. Employer A, which pays $7.50 per hour but hires workers whose credentials in this local labor market usually lead to a $5.50 per hour job, is in some sense a better employer than Employer B, which pays $10.00 per hour to workers whose credentials typically lead to a $10.00 per hour job. Employer A is paying a higher "efficiency wage" differential than Employer B, and presumably expects that this "high wage strategy" will pay off in easier worker recruiting, lower worker turnover, or higher worker morale and productivity. An employer's lower wages may also be offset by better fringe benefits and working conditions that make this job more desirable immediately, or by better training and career paths that make this job an easier stepping stone to high-wage jobs.

4. <u>Because jobs have more characteristics than just wages, employers have many options in responding to pressures for higher wages. Because of these many employer options, government regulation of wages faces some practical limitations</u>. Even if employers have sufficient profits to pay higher wages, they may maximize profits by offsetting these wage increases with other policies. Employers can respond to pressures for higher wages by not creating as many jobs, or, in the case of local wage requirements, by not creating as many jobs in this location. But in addition, employers can

respond to higher wage requirements by increasing the credentials expected of new hires, reducing fringe benefits, degrading working conditions, or cutting back on training. It is difficult for government to prevent all of these possible responses. Therefore, government regulation of wages must take into account that wage standards that are too high may be evaded in ways that are social undesirable. For example, a higher wage standard that makes it harder for the poor to get jobs has some social costs that must be considered.

5. <u>Even if there are limits to how much wages can be increased by living or minimum wages, it may still be desirable to increase the income that the poor can obtain from work. This moral obligation for higher income from work is a social obligation, not an obligation solely for employers</u>. Suppose that a given worker can produce \$*x* per hour worth of goods and services for an employer that pursues a low-wage strategy, a higher \$*y* per hour for an employer that pursues a high-wage strategy, but a morally acceptable standard of living for the worker's family requires a still higher wage of \$*z* per hour. Although it may be just to demand that employers pursue a high-wage strategy (\$*y* per hour), it is unreasonable to demand that employers pay \$*z* per hour. This higher wage of \$*z* per hour reflects society's belief that the worker's family needs that much to reach a minimally decent standard of living. Someone must pay the difference between what the worker can produce, which is maximized at \$*y* per hour, and the \$*z*. It is unclear why this obligation should fall solely on the worker's employer. Rather, this wage differential of

\$($z - y$) should be paid for by broad-based taxes allocated among everyone according to some fair basis. It would certainly be praiseworthy if the employer, as an act of charity, chose to lose money on this worker by paying them \$*z*, which is \$($z - y$) more than the value of what that worker produces;

but, it is hard to see this act of charity as a moral obligation of that specific employer rather than society in general. Finally, to repeat the point made above, even if one felt that somehow the employer had such a moral obligation, it would be difficult to enforce. If an employer is going to lose $\$(z - y)$ by paying this worker $\$z$, the employer will go to some lengths to avoid this loss.

3. THE DESIGN OF LIVING WAGE ORDINANCES

Living wages differ widely in what regulations they impose on what employers. The "living wage" is not one specific policy, but is rather a term for a broad range of employer regulation policies. Whether a living wage policy should be adopted by a local government depends on the policy's specific provisions and the local economy. This may seem obvious, but it is often forgotten. Both proponents and opponents of living wages refer to "the effects" of a living wage, forgetting that the effects of living wages with design X in jurisdiction A may bear little resemblance to the effects of living wages with design Y in jurisdiction B.

Local living wage requirements differ primarily in three areas:

- The required wage level;
- The employers and employees that are covered; and
- How the living wage requirement is enforced.

The wages required by local living wages currently vary from \$6 to \$12 per hour. The median living wage in 2000 for employers providing health insurance was \$8.19 per hour (Neumark and Adams 2001a), almost 60 percent higher than the federal minimum wage of \$5.15 per hour. About two-thirds of local living wages set wages higher for employers who do not provide health insurance benefits.

Living wage requirements also vary greatly in coverage. Local living wage requirements differ in whether they cover service contractors or recipients of economic development assistance. About half of current local living wage requirements cover only service contractors to the local jurisdiction, 15 percent only cover employers that receive economic development assistance, and one-third cover both (ACORN 2001). Most local living wage requirements for contractors or subsidy assistance only cover for-profit employers. However, some local living wage requirements also cover direct employees of the jurisdiction. Also, about 30 percent of living wage requirements include nonprofit employers if they receive contracts or other assistance from the local jurisdiction (ACORN 2001).

For a covered employer, local living wages differ in which employees associated with the employer are covered. Some living wage ordinances only cover employees directly involved with the city contract or subsidy, whereas others cover the entire company. Some living wage ordinances cover all employees, but others exempt part-time or temporary employees, or employees hired through government training, youth employment, or welfare-to-work programs. Finally, some local living wage ordinances not only cover the employer directly involved with the city contract or subsidy, but also that employer's subcontractors or tenants.

Finally, three cities have enacted a higher minimum wage on all employers located in all or a part of the city: Washington, DC, the Santa Monica tourist district, and New Orleans.[2]

[2]A number of states also have a minimum wage exceeding the federal minimum.

Local living wages also differ in how they are enforced. Some local living wage laws have no specific provisions for enforcement, whereas other laws authorize workers' suits, the public disclosure of employer payroll records, and sanctions for noncomplying employers.

Appropriate Wage Rates for Living Wages

The higher the living wage relative to a job's current wages, the more likely the higher wage cannot be accommodated through lower hiring and turnover costs or more training. As a result, the higher the living wage, the more likely that this job will no longer be held by a worker with low credentials, and that instead a worker with higher credentials (more education, more job experience) will be hired. This displacement may not always be evidenced by a worker being fired, but rather by what happens when a new worker is hired. Based on prior research on wage differentials by industry, firm, and unionization, these displacement effects are probably more severe if a living wage raises a job's wages by more than 30 percent.

High levels of living wages will also raise employer costs. The higher the living wage, the more difficult it is for higher wage costs to be offset with lower turnover costs and higher productivity. A higher living wage requirement also means that more jobs are covered at a particular employer, also raising costs. For living wage requirements that cover employees paid via city contracts or grants, a higher living wage requirement makes it more likely that the city will face higher contract and grant costs. For living wage requirements that attempt to cover the contractor's employees who are not funded by the contract—which means that these employees' higher wages cannot be covered through higher contract costs—higher living wages make it more likely that this contractor will avoid doing business with the city. For firms receiving economic development assistance from the city, the higher the living wage requirement, the more likely it is to tip the firm's location decision. Research shows that within a metropolitan area, business location decisions are extremely sensitive to small cost differentials (Bartik 1991). This large sensitivity occurs because different locations within the same metropolitan area are close substitutes, offering similar access to markets, suppliers, and labor. Proponents of a living wage sometimes argue that living wages cannot have much effect on business location decisions because living wages at most increase business costs by 1 percent (Pollin and Luce 1998). But within a metropolitan area, a 1 percent extra cost could easily trigger a different business location decision.

Therefore, an evaluation of whether a living wage requirement is desirable requires an evaluation of how much the living wage raises wages for covered employees relative to current wages. Living wages are often more than 30 percent above the federal minimum wage. However, they are usually much closer to local market wages for most covered employees. The more modest the living wage is relative to local market wages, the less likely the living wage is to cause displacement of workers, increases in city contract costs, fewer bidders on city contracts or grants, or rejections of city locations for new or expanding business establishments. If a living wage only increases the wages of a few jobs by more than 10 or 15 percent, these negative side effects will be modest. If a living wage raises the wages of a significant number of jobs by more than 30 percent, then these negative side effects will be much larger. Of course, the benefits of a living wage also go up with a higher living wage, but the negative side effects seem likely to grow much faster. For example, at the extreme, a living wage of four times the normal wage for a job will result in 100 percent displacement, which means that such a living wage provides few benefits to a low-wage worker with modest education and experience.

Coverage Issues

Public employees

A local government's application of a living wage policy to its own employees falls within its rights and duties as an employer. A public employer must decide its wage policy, specifically whether to choose low wages and low productivity or high wages and high productivity. Higher wages may increase taxpayers' costs, but it is reasonable for taxpayers to pay some costs for government to be an exemplary employer. A local government applying a living wage requirement to itself can also reduce displacement by controlling who is hired. The local government should be willing to hire individuals with low credentials and provide training.

Contracts and grants

A living wage requirement for workers funded through a contract or grant can be viewed as an extension of the government's responsibility as an employer. Although the government does not supervise the daily operations of its contractors or grantees, the government does fund and define the services to be performed. By so doing the government bears some responsibility for how these services are performed, including the wages paid. Because the workers are funded directly by the government, any higher costs will be borne by the local government through higher contract or grant bids per service provided. One problem with contracts and grants is that it is difficult for local government to control a contractor's or grantee's hiring. Therefore, excessive living wage requirements for contractors or grantees may displace low-credential workers. This could justify a lower living wage requirement for contractors or grantees than for the government's own employees.

Economic development subsidies

A business receiving economic development subsidies is not primarily engaged in providing a service defined by the government. The firm is primarily engaged in selling a good or service to make a profit, but in so doing may provide social benefits to the community. Presumably the subsidy was offered to induce the firm to provide greater social benefits, such as the social benefits from greater employment opportunities, greater tax revenue (net of the subsidy), or a better-looking neighborhood. Whether living wage requirements should be imposed on economic development subsidies is a pragmatic issue of what the local government can get away with, given its economy and its competitors.

If the local economy is weak and attracts few businesses and the subsidy is always provided by nearby local governments, it is difficult for the local government to impose a living wage requirement on this subsidy without significant social costs. As already mentioned, the evidence suggests that business location decisions within a metropolitan area are quite sensitive to slight variations in costs. In addition, imposing a living wage requirement on commonly used economic development subsidies, which businesses take for granted, may be interpreted as symbolizing an anti-business attitude. Businesses may fear that such an attitude could lead to future problems threatening profits, such as conflicts with local government over zoning or other regulatory issues. For all these reasons, imposing a living wage requirement on business subsidies is likely to have significant effects on business location decisions. Assuming that the premise of economic development program is correct—new business provides social benefits to the city—this relocation would impose significant social costs.

In contrast, if the local economy is strong, then imposing a living wage requirement may be a reasonable way for a city to allocate its scarce business sites among many business prospects. Alternatively, if the city's economy is weak but the subsidy is an "add-on" to the subsidies typically provided by competing local governments, then the local government may be able to impose a living wage requirement that is less costly then the benefits provided by this "add-on" subsidy. The requirement and subsidy together will reduce business costs. A new subsidy tied to a living wage requirement is less likely to be interpreted as anti-business. The new subsidy/living wage package will probably increase the city's business activity.

Some living wage supporters argue that if a business fails to pay a living wage to all employees, the business is undesirable.[3] But, as argued above, whether a business is a good employer cannot be judged solely by whether it pays each of its employees a living wage. In addition, some economic development subsidies for business development may be justified by the resulting fiscal benefits (net of subsidy) or benefits in improving a neighborhood's appearance, even if employment benefits are slight.

Covering an entire firm or only workers financed by local government

Living wage requirements that cover all employees at a firm receiving a government contract or grant—not just those working on the contract or grant—cannot be interpreted as the government fulfilling its responsibility as an employer. Workers financed by nongovernmental sources are not

[3]For example, David Reynolds, who has written several studies backing the living wage in Detroit and nationwide, asks the following rhetorical question, "Does the community really want to attract firms whose main preoccupation revolves around paying low wages without restrictions from local government?" (Reynolds 2001, p. 85).

carrying out a governmental function. Rather, the local government is using its clout as a contractor to influence the behavior of private employers. Furthermore, the government is using its clout without financing the extra costs created by higher wages. It would be difficult to increase the a contract's price to cover the extra costs due to living wages for the contractor's workers who are not funded by the contract. Doing so would require the government paying higher contract costs to contractors who are currently paying below-living wages to many workers not funded by the local government. Such a policy seems politically and practically infeasible.

Under what circumstances will a local government have enough clout to insist on living wages for workers that it is not directly funding? If the local government is financing a large percentage of a contractor's total workforce, the local government may be able to regulate the wages of the contractor's entire workforce, particularly if the living wage is not too high relative to normal wages. In contrast, if the local government only covers a small percentage of the contractor's total workforce, and the living wage is high, it is more likely that the contractor will refuse to bid. A reduction in the number of bidders may increase costs or reduce service quality in local government contracts and grants.[4]

Covering subcontractors

If living wage requirements are applied to subcontractors who do work financed via a contract or grant from the city, the city could be viewed as having some employer responsibilities by funding and

[4]It is interesting that under the Davis-Bacon Act, "prevailing wage" requirements only apply to workers on construction projects financed by federal dollars, not on all the projects of that construction firm. Apparently the federal government has never chosen to use its clout to require prevailing wages for construction workers it is not funding.

defining the services performed. The living wage's benefits for the subcontractors' workers must be weighted against potential displacement effects on workers with low credentials. For living wage requirements applied to subcontractors whose work is not funded by the contract or grant, the government would in many cases lack sufficient clout to impose such requirements. Finally, living wage requirements applied to contractors of firms receiving economic development assistance would be more difficult to impose if the city's economy is weak and the economic development assistance is typically offered by the city's competitors. Because economic development assistance is often long-term and a firm's contractors may change, applying the living wage to these contractors may result in perceived extra costs due to uncertainty: the firm does not know which contractors it may use ten years from now, and therefore it is difficult to estimate what the living wage requirement may cost.

Covering part-time and temporary workers, workers in job training, welfare-to-work, or youth employment programs

Normal wages for these groups will be lower. A uniform living wage requirement will exceed these groups' normal wages by a greater percentage, increasing displacement. Lower living wage levels for these groups should be considered.

Minimum wages

A city minimum wage would affect far more workers than a living wage for employers with financial dealings with city government. The social benefits from higher wages will be much greater for a city minimum wage than a typical living wage law.

However, the negative effects on city economic development of a higher city minimum wage would be far greater than for most living wage laws. As with living wage requirements for economic development subsidies, a city minimum wage would raise employer costs for city locations relative to non-city locations. However, a city minimum wage applies to far more employers than living wage requirements for economic development subsidies. The typical economic development subsidy applies to new or expanding businesses and is limited to manufacturing businesses or other businesses that export their goods and services outside the metropolitan area. A higher minimum wage also applies to many other employers that might be quite sensitive to location differentials, such as export-oriented businesses that are not new or expanding, or retail businesses or nonprofit employers that serve a metropolitan-wide market. On the other hand, some employers subject to a city minimum wage might be oriented to neighborhood markets and therefore would be less sensitive to a higher city minimum wage.[5]

As mentioned before, research suggests that firms are sensitive to small cost differentials within a metropolitan area. A city minimum wage, with its broader coverage of employers, would have greater negative effects on the city's economic development than living wage requirements for economic development assistance. Although no studies directly estimate the effects of city minimum wages, research on the Philadelphia wage tax may be relevant. Philadelphia's wage tax falls directly on city residents, not employers, but it is commonly believed that the tax forces increases in wages. Two

[5]Some of the living wage's effects on higher labor costs of neighborhood-oriented businesses could be reflected in higher prices of that business's goods and services. These price increases disproportionately hurt lower-income city residents, who shop more locally.

studies suggest that Philadelphia's wage tax has significant negative effects on the city's economic development relative to its suburbs (Inman 1987; Grieson 1980).

If a city's economy is weak, these negative effects of a city minimum wage on city economic development would be a great concern. However, if a city's economy is strong, some slowdown in city growth might be acceptable or even desirable.

These objections to a city minimum wage have less force for higher minimum wages for a metropolitan area or state. Higher state or metropolitan minimum wages would raise costs relative to alternative locations. However, these alternative locations are not close substitutes, because they do not offer similar access to markets, inputs, and workers. Because locations across different states and metropolitan areas are not close substitutes, it is not surprising that studies suggest that higher costs in a state or metropolitan area have moderate effects on its economic development (Bartik 1991, 1992).

Enforcement Issues

At first glance, enforcing living wage requirements seems easy. Enforcement requires determining whether workers are paid the living wage, which can be examined in payroll records. However, a more complex issue is determining who is covered. Furthermore, a living wage campaign might want to minimize displacement effects. To do so requires some government intervention in hiring procedures, which is difficult. Finally, living wage requirements have often been passed by activist campaigns over the objections of city administrators. As a result, living wage advocates may doubt whether the city administration will enforce the living wage law vigorously.

Because city administrations are often distrusted by living wage advocates, many living wage laws include provisions for public disclosure of payroll and other business records. Public disclosure is perceived by employers as a extra cost. Many employers believe that public disclosure of wage and business records could create morale problems among their employees, give some advantage to competitors, or, for employers with cash-flow problems, cause suppliers or creditors to make financial demands.

Living wage requirements applied to the city's own workers are easier to enforce. Furthermore, if the city workforce is unionized, the union has both a strong interest in enforcement and the capability of analyzing the relevant payroll data to determine compliance. City unions could also help enforce living wage requirements on contractors, without public disclosure, by being granted some role in monitoring compliance.

Only a few living wage laws have seriously dealt with potential effects on displacement. These laws, in Boston and New Haven, require covered employers to use community-based agencies as a first source for new hires. Evidence from similar programs, without living wage requirements, in Portland, Oregon, and in Minneapolis, suggest that such programs can change hiring practices if they do a good job of screening or training neighborhood residents to ensure that they have appropriate qualifications for the job openings (Bartik 2001, chapter 9).

For some types of economic development subsidies, living wage requirements might be relatively easy to enforce with minimal displacement. For example, some economic development subsidies provide job training for specific occupations. These subsidies can easily require a living wage.

Furthermore, the process for selecting trainees can be negotiated with the employer, allowing for some attempt to include disadvantaged residents.

4. RESEARCH USING DATA ON THE POST-ENACTMENT EFFECTS OF LIVING WAGES

Most living wage research studies have been predictions of future effects of proposed living wage laws. These studies have usually been sponsored by living wage proponents or opponents. Proponents emphasize the living wage's benefits to workers and modest effects on employers' costs (Pollin and Luce 1998; Reich, Hall, and Hsu 1999; Reynolds 1999). Opponents emphasize the possible negative effects of living wages on labor demand for less-educated workers (Sander, Williams, and Doherty 2000; Tolley, Bernstein, and Lesage 1999). Such predictions are suggestive but not definitive, because the predictions are based on implicit or explicit models, not on what actually occurs after the enactment of living wage laws.

Only eight studies have analyzed data on the post-implementation impact of living wages. Three of these studies are of Baltimore, the first U.S. city to implement a living wage requirement, in December of 1994.[6] One study examines the Los Angeles living wage law, and another the Detroit living wage law. Finally, three studies authored or co-authored by David Neumark use pooled time-series, cross-section data on economic outcomes for workers in 21 cities with living wages, compared with hundreds of other cities.

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[6]A few cities had laws similar to living wages before 1994. For example, San Jose in 1991 adopted a law that required city contractors to pay prevailing wages, and Gary in 1991 adopted a law requiring firms receiving tax abatements to pay prevailing wages (Reynolds 2001, p. 134, from data provided by ACORN). However, the national living wage movement was sparked by the 1994 Baltimore law.

The three studies of Baltimore focus on whether the Baltimore living wage law, which was limited to contacts, increased the city's contracting costs. The first study, by living wage proponents, compared 23 contracts before and after the enactment of Baltimore's living wages (Weisbrot and Sforza-Roderick 1996) and concluded there was no significant increase in the city's contracting costs. A second study, by the Employment Policies Institute (1998), a staunch opponent of minimum wages and living wages, criticized the Weisbrot and Sforza-Roderick study, claiming that some data were erroneous. The reply by Weisbrot and Sforza-Roderick to this critique is that correcting for these problems would not change the conclusion that living wages did not significantly increase contracting costs. Finally, a later study by living wage supporters examined a larger number of Baltimore contracts over a longer period and restricted attention to contracts whose scope of services was clearly unchanged (Niedt et al. 1999). This study also found no significant increase in Baltimore's contracting costs due to the living wage. This study also provided evidence from interviews with selected workers on how the living wage helped these workers, increased their productivity, and reduced worker turnover.

The problem with these studies is that measuring the real cost of contracted services to a city is difficult. Ideally, we would like to divide a city's total contracting costs by the real value of services provided in all city contracts. These three studies focus on contracts providing similar services both before and after the living wage, but real contracting costs per unit of service can also go up by keeping the contract's costs the same and reducing services. A city may have limited flexibility in total spending on many contracts either because funds are passed through from state or federal grants, or because city budget adjustments are difficult. For such contracts, adjusting services downward is the most plausible way in which the real costs of services might increase due to living wages.[7] By selecting contracts in which the services are unchanged, these studies may be selecting employers with the smallest cost increases due to the living wage.

Even if services might have been cut in some Baltimore contracts, these three studies suggest that Baltimore's ordinance did not in its first years cause the city significant financial difficulties. However, this lack of city financial impact may not be generalizable to all living wage laws because Baltimore's law is more limited than most living wage laws. Baltimore's ordinance is limited to contractors, and among contractors, only covers workers who are directly financed through the contract. In addition, Baltimore's living wage in its first years was at modest levels ($7.02 in year-2000 dollars) compared to other cities having living wages, with no higher living wages for workers not covered by health insurance.

The Los Angeles study was based on interviews with city officials and contractors (Sander and Lokey 1998). It provides anecdotal evidence on the effects of the city's living wage on contractors' workers, employment levels, and hiring practices, and the city's contracting practices and costs. There were significant lags in fully implementing Los Angeles' living wage, with the ordinance as of 1998 only affecting 15 to 20 percent as many workers as predicted. This is partly because some workers were still working on old contracts. But it is due also to city administrative practices that exempted 60 percent of new city contracts from the law, and to lack of compliance, with one-third to two-thirds of covered employers not complying with the living wage. The study finds that the living wage increases

[7]As mentioned later in this paper, Sander and Lokey (1998) found that this is one method of city and contractor adjustment to higher costs per unit of service due to living wage laws.

wages for some workers above the living wage, as employers try to maintain wage differentials. With employment and costs, the study suggests that effects only occur for firms that have many employees whose wages are forced up by the living wage requirement. The authors claim that they find instances of all the living wage effects claimed by proponents and opponents: cost increases for some contracts, reduction in services and employment decreases under other contracts, some contracts in which firms increase productivity to pay the extra costs. Among the ways in which productivity increased is to hire more productive workers. The study is unable to quantify the relative importance of these different adjustments to the living wage. Adjustments take place the most when there is more scope for choice: for example, cost and service adjustments take place more when contracts are rebid, and changes in the mix of workers happen more through attrition and hiring than layoffs.

The Detroit study focuses on the application of that city's living wage to contracts with nonprofits (Reynolds 2000). The study is based on surveys of 64 nonprofits and interviews with a selected 15 of these 64. The surveys suggest that a little more than one-third of the nonprofits perceive a significant or major impact of the living wage requirement on their operations. The study focused the interviews on nonprofits claiming significant or major impacts. On the basis of these interviews, the study claims that about one-third of those claiming large impacts are mistaken due to a misunderstanding of the law or the survey. (The researchers did not conduct follow-up interviews with nonprofits claiming "minimal" or "minor" impacts of the living wage to see if their survey response may also have been biased by misunderstanding.) Some of the significantly affected nonprofits responded by service cutbacks or layoffs. According to the study, one reason that Detroit's law had modest impacts is that the law did not cover workers at the nonprofits who were funded by non-city sources.

The study recommends that the city minimize layoffs and service cutbacks in nonprofits by providing supplemental funds to nonprofits for whom the living wage imposes costs that are large relative to the nonprofit's budget. Such a policy is estimated to have modest costs for the city's budget.

Neumark's studies are the most econometrically sophisticated research on the living wage (Neumark 2001; Neumark and Adams 2001a, 2001b). These studies pool cross-section and time-series data on metropolitan areas from 1995 to 2000. Included are 21 metropolitan areas that contain cities that implemented living wage laws and over 200 other metropolitan areas. The data used come from the Current Population Survey, both the Outgoing Rotation Group with monthly data on employment and wages during a typical week and the Annual Demographic File with data on earnings and income of the worker and family during the previous year.

Neumark (2001) finds that living wage laws covering contractors have significant positive effects on the wages of unionized local government workers who earn below the MSA median wage. The elasticity is 0.14 to 0.16, implying that a living wage 60 percent above the minimum wage will increase these workers' wages by 7 percent.[8] These effects do not occur for non-union or nongovernmental workers below the median, or for living wage laws covering economic development assistance. Neumark and Adams (2001a) find that living wages have significant positive effects on the average wages of all workers in the metropolitan area in the lowest 10 percent of the wage distribution, but only after a lag of about a year. The estimated elasticity is 0.05 to 0.07: a living wage 60 percent

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[8]An elasticity of 0.15 means that a living wage that is 60 percent above the minimum wage will increase ln(wage) by 0.15 times ln(1.60), or 0.0705, which increases actual wages by a factor of exp(0.0705) = 1.073, or 7 percent. Similar calculations are done to translate the other elasticities into percentage effects. As noted in the paper, the median living wage among cities is $8.19, almost 60 percent higher than the federal minimum wage of $5.15.

above the minimum wage increases average wages of lowest-decile workers by 3 percent. However, the employment rates of workers predicted to be in this lowest-decile also drop by a significant amount. The estimated elasticity is –0.14: a living wage that is 60 percent above the minimum wage will reduce employment in this lowest-decile group by 6 percent. These wage and employment effects on the bottom decile only occur significantly for living wages covering economic development assistance, not those covering only city contractors. Finally, Neumark and Adams (2001b) estimate that city living wage requirements significantly reduce the overall poverty rate in the MSA. The elasticity is about –0.17: a living wage 60 percent above the minimum wage will reduce the number of poor people by 8 percent. These antipoverty effects are limited to city living wages that include economic development assistance.

The problem with Neumark's and Adams' results is that the magnitude and pattern of these effects seem implausible. The results for unionized local government workers are plausible, as living wage laws improve the union's bargaining position by increasing the costs of contracting out, and in some cities directly raise city workers' wages. However, the effects on private wages in Neumark and Adams (2001a) seem implausibly high; as they point out, a living wage's effects should depend on the proportion of workers covered. If 100 percent of all the lowest decile workers were covered by the living wage, one expects an elasticity of around 1, in which a 60 percent increase in the living wage would raise these workers' wages by 60 percent. But estimates suggest that, out of all workers in the bottom quartile of wages, living wages cover less than 1 percent (Neumark and Adams 2001a). The elasticity of these workers' wages with respect to the living wage should be around 0.01. But Neumark and Adams estimate an elasticity of 0.05 to 0.07, about six times too big.

The employment elasticity of –0.14 also seems large given a wage elasticity of 0.05 to 0.07. Most estimates of the elasticity of relative demand for a type of labor with respect to its relative wage are between 0 and –1 (Bartik 2001), whereas Neumark and Adams's results imply an elasticity of around –2.[9] Furthermore, the employment and wage results seem inconsistent with the poverty results. Because the employment elasticity is negative and over twice as large in absolute value as the wage elasticity, the estimates imply that typical weekly earnings go down unless living wages have large effects in increasing weekly work hours, which seems unlikely.[10] If weekly earnings go down for lowest decile workers due to living wages, how can living wages reduce poverty? The only explanation is some divergence in the living wage's effects between the working poor and low-wage workers.

Finally, the poverty reduction due to living wages is much greater than expected. The estimated anti-poverty effects of living wages are greater than expected for similar-sized increase in the minimum wage. For example, Houseman (1998) suggests an elasticity of poverty with respect to an increased minimum wage of –0.1, even if a higher minimum wage has zero effects on employment.[11] Neumark and Adam's (2001b) estimated elasticity for the living wage of –0.17 is almost twice as large as the

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[9]The employment elasticity of –0.14 divided by the wage elasticity of 0.06 implies a relative labor demand elasticity of –2.33.

[10]Neumark and Adams (2001a) report positive hours effects for employed workers in a footnote, but they do not report the magnitude.

[11]Houseman estimates that the 1997 increase in the federal minimum wage from \$4.25 to \$5.15 per hour reduces poverty among wage and salary workers by 3.2 percent, with zero disemployment effects assumed. Only 57 percent of all poor families include a worker. Assuming the minimum wage has no effect on families without a worker, the percentage effect of the 1997 minimum wage increase on overall poverty would be 1.8 percent (0.57×3.2 percent). The resulting elasticity of poverty with respect to the minimum wage is –0.095 ($= [\ln(1 - 0.018) - \ln(1)] / [\ln(5.15) - \ln(4.25)]$).

simulated effects of a minimum wage. This is difficult to believe because the living wage covers far fewer workers.

Neumark and Adams (2001a) suggest that the surprisingly large effects of living wages can be explained by the potentially large number of employers that receive economic development assistance. I am skeptical of this argument, because large economic development subsidies typically only go to new and expanding manufacturing companies. New or expanding manufacturers are a small share of the labor market. Manufacturing firms often pay high wages, so only a small proportion of workers at such firms would be affected by living wage laws. The limited information available suggests that even living wages for economic development assistance only cover a small proportion of the labor market. For example, Neumark and Adams' (2001a) own numbers (derived in part from Pollin and Luce 1998) suggest that Los Angeles's living wage ordinance, which includes recipients of economic development assistance, would only directly raise wages of 0.76 percent of workers in the lowest quartile of the wage distribution.[12] Finally, even if living wage laws had broad coverage, this would not explain how living wage laws can reduce both weekly earnings and poverty.

Neumark and Adams' results might be due to living wages causing large changes in social norms. Changes in social norms about "fair wages" could push wages up for noncovered employers, or by more than the law requires. To explain the poverty results, assume that changes in social norms lead employers to diversify their hiring to high-poverty groups. Living wage laws may reduce overall employment, but workers from high-poverty groups would be substituted for other low-wage workers.

[12] Los Angeles has a relatively high threshold for assistance, $100,000 on an annual basis, which weakens this point somewhat. However, many city living wage laws have sizable thresholds for triggering the living wage.

An alternative explanation of Neumark and Adams' results is that they are biased by unobserved city trends. Living wages were adopted in many cities in the mid to late 1990s. During this period, the U.S. economy moved towards low unemployment, which increased wages and earnings of lower income families. Most living wage cities, at least in Neumark and Adams's sample, are larger cities in the Northeast and California (16 of 21 cities). Such cities may have benefitted more than most cities from the late 1990s trends. Some evidence suggests that these living wage results may be fragile. For example, Neumark (2001) reports that the estimated wage effects for unionized local government workers often became statistically insignificant if Detroit observations were dropped.

5. THE POLITICAL LESSONS FROM THE LIVING WAGE MOVEMENT

Whatever the living wage's merits as an economic strategy, the living wage is a success as a political strategy. In city after city, the living wage has mobilized a broad coalition of labor unions, community groups, and religious organizations around issues related to wages and poverty. This coalition has been able to win considerable public support, as evidenced by the victory of living wage campaigns in all public referenda but one and the ability to persuade many city councils to adopt living wages. Such coalitions can then influence city policy on other poverty-related issues. As one proponent of living wages said after Boston's adoption of the living wage, "In Boston, the mayor's office wouldn't return our calls last year, and now we're in regular meetings." (Swope 1998, p. 25).

The political success of living wage campaigns suggests lessons for proponents of poverty reduction. Focusing on the poor may not be the best political strategy for reducing poverty. A focus on the poor may elicit less support from the many non-poor who believe themselves immune from poverty. Focusing on the poor's problems may imply that the solutions to poverty come from the poor changing their character and skills.

A political strategy to reduce poverty may be more successful if it focuses on institutional or social conditions that affect the well-being of many lower-middle class and working class groups, not just the poor.[13] Wage rates are one such issue. Other issues might include child care, schools, and post-secondary education and training.

6. CONCLUSION

What should local governments do about the living wage? In answering this question, we should recognize the difficulty of identifying other local policies to increase the earnings of lower-income families. "Training" is often proposed as an alternative, but training is expensive and usually results in modest returns per training participant. We could leave income distribution to the federal and state governments, but this may be a recipe for inaction. On the other hand, the need to do "something" about poverty and low wages does not justify adopting living wage requirements if their design or the city's circumstances imply that the living wage will reduce the earnings of lower-income families.

Based on theory and research, moderate living wage requirements applied to the local government's own employees, and contractors' and grantees' employees who are funded by the local government, may do more good than harm. The requirements should not try to push wages up by more than 30 percent over currently prevailing wages, because too high a living wage leads to a high risk of

[13]This argument is reminiscent of Skocpol's (1991) argument that the most effective anti-poverty policies are "targeting within universalism."

displacement (that is, workers with higher credentials replacing those with more modest credentials). Some living wages have been set too high. Living wages should be accompanied by policies to train lower-income city residents for job openings in the city or with contractors. Living wage requirements should not be applied to a contractor's or grantee's employees who are not city-funded. For these employees, the city in most cases has neither the clout to insist on higher wages nor the financing to help pay for higher wages. Finally, city unions should play a role in enforcing living wage requirements for city employees or contractors. This allows for effective enforcement without full public disclosure of payroll records.

The merits of living wage requirements for recipients of economic development assistance depend on the local economy's strength and whether this assistance program is used by the city's competitors. If the city's economy is weak, living wage requirements should only be used if the economic development program is an add-on to commonly used economic development programs, so that the economic development program plus the living wage requirement provide a net competitive advantage for the city. Living wage requirements applied to "normal" economic development assistance—programs used by many nearby competing jurisdictions—are likely to reduce the city's economic growth, which is a serious problem if the city's economy is already weak. If the city's economy is strong, however, a living wage requirement for normal economic development assistance may be a useful part of a "managed growth" policy. Enforcing living wage requirements for economic development assistance is easier for economic development programs that are labor-oriented; for example, programs that provide training subsidies or hiring subsidies.

Research on living wages should be strengthened. We need both more detailed post-enactment case studies, and econometric studies that compare living wage and non-living-wage cities with better controls for other city characteristics.

Finally, whatever one's position on the living wage, we need to consider the moral challenge posed by the living wage issue: how can local governments creatively respond to the problems of low wages and poverty? Living wage advocates have proposed one solution which even they admit is inadequate. Both proponents and opponents of living wages have an interest in developing local government policies that might reduce poverty and increase wages, while avoiding the drawbacks of living wage requirements.

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