The Economics of a Living Wage

by Bill Barclay

Living Wage Ordinances and Their Roots

Living wage ordinances have now been implemented in well over 100 cities and towns in the U.S. In fact, over 40% of all residents of cities with 100,000 or more people live in places that have enacted such ordinances. The ordinances and the movement behind them are driven by the decline in the real (inflation adjusted) value of the minimum wage, the stagnation in real family incomes over the past three decades and the dramatic – unprecedented – increase in income inequality during this same period. There have been a lot of numbers used to describe this inequality but perhaps be best is the following: if the employees' wages had increased as rapidly as the average compensation of CEOs at the largest companies, on average employees would now be making over $200,000. Obviously they are not. Thus efforts to pass living wage ordinances are part of the larger fight against growing inequality and thus a living wage is best defined as a wage **floor** high enough to allow a full time worker to support of a family.

The Arguments of Opponents

For many, maybe most, of those reading this article the very fact of the extreme inequality in U.S. incomes may be sufficient to justify a living wage ordinance. However, when we talk with others, including many elected municipal representatives, we often find that, not only are they are not persuaded by our moral arguments; they seem to approach the question from a very different framework. It is useful to determine what that framework is and then to determine how we can respond to them arguments that flow from it.

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Opponents of living wage ordinances usually make three interconnected arguments; sometimes these are explicit and at other times they underlie more general expressions of opposition to enacting a living wage. These arguments can be summarized in the following propositions:

- In a market economy workers received in salary the value of what they produce, they are paid what they are worth;
- Increasing the price of a good – in this case, labor – will reduce the demand for the good; and
- Capital – businesses – is mobile and will move away from municipalities that enact living wage ordinances and avoid them in the future.

The outcome of these three propositions appears to be that living wage ordinances will end up hurting the very people they are intended to help. Low-wage workers will be laid off and the businesses that employ them will leave the community, further reducing opportunities for those at the lower end of the income scale. The further irony is that these arguments are commonly made by people who otherwise exhibit little concern about inequality or the financial problems facing low-wage workers. All of a sudden they become their champions – certainly a very frustrating state of affairs for most of us.

From a market fundamentalist perspective these are incontrovertible statements. And it is such a perspective that has dominated U.S. political discourse over the past several years. However, it is essential to realize that these are predictions, based upon a particular model of the economy, and their accuracy must be tested against reality. Fortunately, from the experience of the more than 100 living wage ordinances in place, we have a lot of reality against which to test these predictions.

The Evidence of Experience

It is worth beginning by noting that these propositions are very similar to those made by opponents of minimum wage increases (or even the existence of a minimum wage). In this case, however, economists have largely moved beyond these extreme predictions and are now arguing over whether the employment impact of an increase in the minimum is zero, modestly positive or slightly negative. Political discussion has lagged this recognition.

Of course, living wage ordinances are different in two important ways from minimum wage increases. First, living wages are normally set much higher that minimum wages. This has ranged from New Orleans' 19% increase over the state's minimum wage to Santa Jose's 117% increase over California's minimum wage. Second, living wage ordinances impact a relatively small portion of a municipality's labor force, almost always less than 5%. In addition, living wage ordinances are not homogeneous, various communities have fashioned their own with the result that there are significant differences in their scope and financial impact.*

In comparing the experience with living wage with the

predictions outlined above, it is useful to consider three dimensions. First, how have covered firms responded to living wage ordinances, *e.g.* have they laid off workers, relocated to other venues, or absorbed the wage increases internally? Second, what has been the impact on the cost of services provided to municipalities by covered firms, *i.e.* have taxpayers faced increased costs? Finally, has the existence of a living wage ordinance reduced competition in bidding to provide services to municipalities, also perhaps increasing costs to the municipality?

There are a variety of ways that firms can respond to mandated wage increases and these include more than simply laying off employees or relocating. However, the first point to make from the several studies of living wages is that there is no evidence of layoffs or declines in employment by covered firms. Put another way, in the case of living wages as in that of minimum wages increases, the dire predictions of opponents have not been realized. In fact, in some cases, such as Boston, employment has actually grown faster in the covered firms than among non-covered firms. Although this may seem counterintuitive, at least from the perspective of the market fundamentalist propositions described above, it reflects the reality of the small impact on firm revenues that living wages involve and the use of other options. Most living wages represent 2 – 3% (or less) of the revenues at covered firms, not an amount significant enough to generate layoffs.

The outlier in this respect is Santa Monica CA where the living wage impact on hotel and restaurant businesses represented 10% of total revenues. However, even here, firms did not layoff workers or relocate because of the "tourist destination" character of Santa Monica; businesses wanted very much to remain in the city. Relocation has been virtually nonexistent in response to living wage ordinances, largely because these ordinances are designed to cover work performed under contract to the municipality without regard to where the contracting firm is located.

So how have covered businesses responded to living wage ordinances? Largely through one of three methods: increasing prices, improving productivity, and accepting an internal income redistribution. Price increases, where they occurred, have been quite limited. Los Angeles experience the largest one. But it amounted to only 0.2% of the city's budget, probably a large dollar figure but a *de minimus* amount for any individual taxpayer. Most of the impact of living wage ordinances has been absorbed by increasing productivity at the covered firm level. This has occurred in two ways. First, firms have looked carefully at the way in which work is organized and made changes that enhance efficiency. Second, employee behavior has also increased productivity, both because of increased morale and because of significantly reduced turnover in what are now much better paying jobs. In turnover in covered firms decreased from 80% to 20%, a significant cost savings for the firms.

What about the cost charged for outsourced services? After implementation of living wage ordinances the outcome has ranged from declines in real terms (*i.e.* cost increases less than the rate of inflation) in Boston, Baltimore (the city with the longest experience with a living wage ordinance), Dane County WI, and New Haven to an increase of 33.4% is Hartford CT. Hartford is definitely an outlier (the next largest increase was 9.1% in Corvallis OR). On further analysis look it appears likely that the city's methodology for contract bidding was probably the major cause of this increase in service costs: Hartford accepted bids on a per hour cost basis with no caps on the amount of hours to be utilized.

Finally, there has been little if any impact on the level of competition in bidding for municipal contracts. One interesting, and perhaps unanticipated outcome, however is the possibility that living wage ordinances may force firms to bid more on quality of service provided rather than engaging in a race to the bottom by reducing employees' wages. Because the floor wager is set by the living wage ordinance, firms cannot simply undercut competitors by reducing wages and benefits.

In sum, the evidence from actually experience with living wages in a large number of cities of varying sizes contradicts the market fundamentalist propositions outlined above. Instead, a living wage ordinance is a viable approach to lessening the inequality of a number of workers without imposing undue burdens on others.

A last point may be worth noting here. Some argue that, while living wage ordinances maybe sometimes desirable, now is not the time to enact one because of the depressed economy. This, it seems to me, is exactly backwards. Firms find the assured income stream from government contracts desirable, and especially so in these difficult times. Living wage ordinances will not change that perception, so *now* is the best time to act.

* The draft living wage ordinance proposed for Oak Park's is on the broader end of the continuum. It would include all three categories of workers: those who work directly for the Village of Oak Park, those who work for firms contracting with the Village to provide services, and those who work for firms that receive economic development subsidies from the Village. Its mandated living wage level of $14.84/hr represents an 85.5% increment over the Illinois minimum wage of $8.00/hr. A copy of the ordinance, as proposed, is posted at http://www.chicagodsa.org/draftvoplwl.pdf.

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