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POLICY BRIEF

A National Movement Hits Close to Home: The Living Wage Proposal in Washington State

by Carl Gipson
Director, Center for Small Business & Entrepreneurship

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Executive Summary

The term "living wage" has been used in a vague sense for many years – referring generally to a job that pays a wage capable of supporting a household or family. Politicians use the term to describe "living" or "family-wage" jobs – jobs that pay enough to support a middle-class family.

But "living wage" has also become to mean something completely different over the past 15 years. Living wage is now used as a policy term to mean a "hyper" or "super" minimum wage – a mandated wage floor based not on work value or productivity, but as a labor price control meant to guarantee a certain standard of living.

Supporters of a mandatory living wage are concerned that some people with low paying, low-skill jobs are unable to support a family in today's economy. They are convinced that the best way to lift people from the ranks of the working poor is a law to guarantee a wage level high enough to remain off of government assistance programs.

This Policy Brief reviews proposed private-sector living wage ordinances and their applicability to Washington state – using Spokane's proposed living wage ordinance as a model. Even though the proposal did not qualify for the 2007 November ballot, it is the farthest-ranging living wage ordinance to make it this close to becoming law in Washington state (only missing qualifying for the ballot by several hundred signatures).

The proposed ordinance would require that large retail organizations pay all employees at least 135 percent of the state's minimum wage if health care benefits are provided, or 165 percent of the minimum wage if benefits are not provided. The city of Bellingham passed a living wage ordinance in 2002, but it is very limited in its scope, only affecting a handful of city contracts and vendors.

1. History

A living wage ordinance (LWO) is a kind of minimum wage in that it is an intervention by governments to set the price of labor. National policies affecting labor market pricing have been in effect since the 1930s, with the passage of the Fair Labor Standards Act of 1938. That Act applied federal wage rate standards to manufacturing employees engaged in interstate commerce or in the production of goods for interstate commerce. Initially set at $0.25 per hour, the federal minimum wage has been raised many times over the last half century (most recently in July, 2007).

Washington lawmakers passed a state minimum wage law in 1961, setting the rate at $1.15 per hour. Lawmakers raised the state's minimum wage one-to-three times per decade over the 1960s, 1970s and 1980s. With the passage of Initiative 688 in 1998, the wage is now on auto-pilot, automatically rising every January 1st based on a calculation of the Consumer Price Index.

Currently, Washington's minimum wage is the highest in the nation, $7.93 per hour. It is clear that based on the past few years' increases (30 cents in 2007, 28 cent in 2006, 19 cents in 2005) Washington's minimum wage will break the $8 per hour mark in 2008. This is well above the present federal minimum wage of $5.85 per hour.

Living wage ordinances began appearing in the mid-1990s. The city of Baltimore was the first city to pass a living wage ordinance (1994), but it applied only to companies that provided contracted services for the city. Proponents argued that private companies benefiting from taxpayer-funded contracts should be forced to pay a living wage to their employees. In fact, almost all of the more than 100 living wage ordinances passed by cities and counties in the last fifteen years apply only to government contracts with private companies, not to general businesses or industry-specific companies.

2. City of Chicago

In the summer of 2006, the city of Chicago came the closest of any city to implementing a private-sector living wage targeted to large retail organizations within city limits.

Pushed by the Association of Community Organizations for Reform Now (ACORN) and other political organizations, the proposal would have mandated that retail organizations with more than 75,000 square feet or with more than $1 billion in gross revenues pay workers at least $10 per hour with an additional $3 per hour in fringe benefits by 2010.

The Chicago city Aldermen (city council) passed the LWO by a vote of 35-14 in July 2006, but Chicago Mayor Richard Daley vetoed the measure. The city Aldermen failed to override Mayor Daley's veto.

The Mayor said he vetoed the measure because of its immense harmful economic impact. The measure would have applied to just over 40 large private retail stores that employ thousands of Chicagoans. Several of the retail organizations said they would be forced to pull out of the city, relocate expansion plans to outside city limits, or adopt other drastic measures. Chicago officials estimate the city already loses $300 million a year in sales taxes (on $5 billion in sales) when city residents go shopping outside city limits. City officials worried the defection of shoppers would have ballooned had the living wage measure been upheld.[1]

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[1] Information compiled from *The Wall Street Journal*, "The Red-Lining of Chicago," July 31, 2006 and *Investors Business Daily*, "Big Win for Big Boxes," September 13, 2006.

3. Government Contracts and Living Wage Ordinances

By far the majority of the existing living wage ordinances throughout the nation apply only to agreements for services between local, city or municipal governments and private contractors and subcontractors. The Spokane LWO is actually more of an exception, since it is between two private parties, whereas Bellingham's LWO is the more common type.

In Washington state, only the city of Bellingham has a living wage ordinance in its regulations – and again, it applies only to city contracts with private vendors and subcontractors. Passed in 2002 by the City Council, the wage levels are now $10.81 per hour for employees with health benefits and $12.43 without benefits. But only four of the 1,093 city contracts were affected by the ordinance, largely because of the state's prevailing wage laws.[2]

Washington state's prevailing wage law is the big reason why a municipal/private vendor LWO is almost irrelevant. Prevailing wage laws require Washington private sector firms (often in construction) to pay their workers pre-set wages when working on public projects.

Modeled after the federal Davis-Bacon Act, the Washington State Public Works Act (prevailing wage) sets wages for public works based on a complex survey formula and is already well above the local market wage. This prevailing wage system works like a living wage ordinance. Even though the wage levels are set to corresponding geographic locales, the principle remains the same. This is why many cities' LWOs are relatively ineffective and unenforceable.

Other reasons Bellingham's LWO is mostly without effect are the many exemptions that were included in order to minimize the cost of the ordinance to the city. New businesses, part-time employees, contracts smaller than $10,000, government agencies and unionized employees are all exempted from the LWO.

But while Bellingham's LWO is fairly irrelevant on the government's side, the effects on municipal employment are not irrelevant. Nationally, adopting a living wage ordinance, holding constant time and municipal effects, is followed by a 10.21 percent decline in municipal employment and a 10 percent decline in total payroll.[3] There is little doubt that LWOs affect the private sector because of the disruption they cause to the employer/employee wage equilibrium. Further evidence shows that government-only LWOs also reduce municipal workforces, personnel budgets and payroll.

4. Spokane's Living Wage Ordinance

In the spring of 2007, a political action group, the Peace and Justice Action League of Spokane (PJALS), announced a campaign to place a living wage ordinance on the November 2007 ballot. PJALS would have had to collect 2,915 valid signatures from voters registered

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[2] "Bellingham living-wage law aids few," Sam Taylor, *The Bellingham Herald*, February 20, 2007.

[3] Robert P. Strauss, "Distributional, Employment, and Budgetary Effects of Living Wage Ordinances," Employment Policies Institute, September, 2006.

within the city of Spokane. In July, PJALS submitted over 3,800 signatures, but election officials found over 1,200 signatures were invalid (unregistered, duplicate names, etc.). Therefore, the LWO was not on Spokane's November 2007 ballot.

Because of the growing movement pushing LWOs around the nation, however, this paper focuses mostly on the proposed Spokane LWO because of the immediate and large impact it would have had on the general business community, and because it could serve as a model for other cities around the state.

Spokane's LWO details would have closely mirrored several other ordinances introduced in past years in other cities across the nation. The basics consist of a mandated wage; one level if a job is accompanied by health insurance benefits and a higher level if it is not.

The proposed Spokane LWO ballot title read:[4]

Ballot Title

Shall an ordinance be enacted requiring retail establishments with 95,000 square feet or more within the Spokane city limits to pay a minimum wage of 135% of the state minimum wage if the retailer provides health benefits and 165% of the state minimum wage if the retailer does not provide health benefits to employees who work 16 hours or more per week, after three months of employment?

Voters would have chosen whether to enforce these wage levels onto the retail industry inside Spokane city limits. Using 2007's minimum wage of $7.93 per hour, no employee of a large retail establishment, full-time or part-time (16+ hours per week), would earn less than $10.70 per hour if health care benefits are included or $13.08 if health benefits are not included.

How did proponents of the LWO decide to target the retail industry? Some of the language in the proposed ordinance is strongly inflammatory and helps reveal some of the thinking of the political activists behind such a proposal.

Among some of the language in the proposed ordinance (also known as the Whereas clauses) are these, emphasis added:[5]

1. WHEREAS, large retail establishments *often adversely affect* small to medium sized local businesses and the economy; and,

2. WHEREAS, some large retail establishments pay low wages and offer minimal benefits, *which forces other businesses to either do the same* or be driven out of business; and,

[4] http://www.users.qwest.net/~jalof/livingwage/LWpetition2006.pdf
[5] http://www.users.qwest.net/~jalof/livingwage/LWpetition2006.pdf

3. WHEREAS, large retail establishments *have sufficient market leverage* that enables them to pay a living wage and provide health benefits while still making a profit; and,

4. WHEREAS, to counter these tendencies and to provide for the economic, health and well-being of its citizens, *new standards of economic conduct should be established* for such large retail establishments; and,

5. WHERAS, it is essential that large retail establishments provide a living wage, along with health and other benefits required for employees to take care of their families.

Sound public policy is based on a few basic principles. One of these is that the use of voluntary incentives to promote good policy is far better than the threat of coercion. Here, proponents of the LWO assume that large retail businesses *always* harm the local economy and are the *source* of the working poor, despite research showing that the presence of a large retailer often drastically reduces the cost of living for consumers, which helps reduce poverty.

They also assume that the only way, or at least the most efficient way, to pull people up the socioeconomic ladder is through a top-down regulatory approach. They assume that government officials should determine when a business has enough profit to warrant levying higher costs on that business. They also seem ignorant of the economic reality that very large companies can, and often do, have narrow profit margins.

Establishing public policy based on ambiguous concepts like "sufficient market leverage," and "new standards of economic conduct" is dangerous to the rights of citizens and a poor way to make public policy.

5. Defining "Living Wage"

The numbers proponents used in estimating what an actual living wage would be (135 percent and 165 percent) are taken from a report published by the Northwest Federation of Community Organizations' 2007 Northwest Job Gap Study.[6] The Northwest Federation of Community Organizations is a regional network of several progressive grassroots organizations throughout Washington, Oregon, Idaho and Montana.

The study claims that, in order to provide a living wage in Washington state, a single adult must make $11.16 an hour, a single adult with one child must earn $17.54, a single adult with two children needs $23.39, two adults with two children $21.77 and two working adults with two children must make a combined income of at least $29.95 per hour in order to survive. These figures are presented below.

[6] Dennis Osorio, Will Pitz and Gerald Smith, "*Searching for Work That Pays: 2007 Northwest Job Gap Study.*" Published by the Northwest Federation of Community Organizations. http://www.nwfco.org

Estimates of "Living Wage" Based on Location and Family Make-Up

	WA	King	Spokane
1. Single adult	$11.16	$12.11	$9.87
2. Single adult with one child	$17.54	N/A	N/A
3. Single adult with two children	23.39	$25.99	$20.65
4. Two adults (one working) with two children	$21.77	N/A	N/A
5. Two adults (both working) with two children	$29.95	N/A	N/A

The income needs are slightly lower in the Spokane region because the cost of living is lower than the average in Washington (likewise, King County's is greater because of the higher overall cost of living). Data was not made available for scenarios two, four and five for King and Spokane counties.

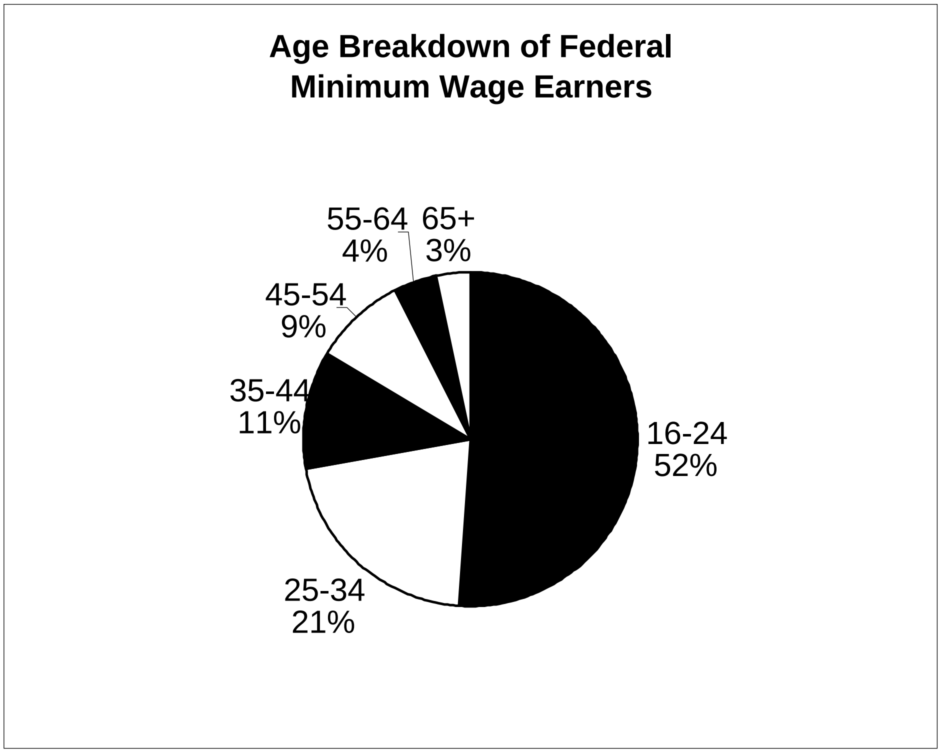
6. Who are Minimum Wage Workers?

It is important to ascertain and examine the characteristics of minimum wage workers, because these are the people that proponents of the LWO are supposedly trying to help most, particularly those low-wage earners supporting a family. A snapshot of minimum wage workers gives an idea of who is supposed to benefit from an LWO.

Unfortunately, an examination of the national statistics shows that an LWO would not necessarily help the low-wage heads of households as much as supporters claim. In fact, most of the benefit would go to people whose income already greatly exceeds the federal poverty level.

A closer look at workers who make the minimum wage illustrates why LWOs are ineffective at relieving poverty. According to the Bureau of Labor Statistics, minimum wage workers are largely unmarried workers who tend to be young. About half the workers earning minimum wage are under age 25.[7]

[7] "Characteristics of Minimum Wage Workers: 2006," Bureau of Labor Statistics, U.S. Department of Labor, February 28, 2007. http://www.bls.gov.



Part-time workers, those working less than 35 hours a week, are also much more likely to earn the minimum wage. The industry reporting the highest proportion of workers earning hourly wages at or below the minimum wages was leisure and hospitality – three-fifths of the nation's minimum wage workers fall into this category. But for many of these workers, mostly in food preparation and service jobs, cash tips greatly add to the official hourly wages they received.

Minimum wage workers tend to be less educated than higher-wage workers. A 2003 Bureau of Labor Statistics study reports on the link between poverty and education:

> "The incidence of living in poverty greatly diminishes as workers achieve higher levels of education. People with higher levels of education have better access to higher paying jobs…than those with lower levels of education."[8]

In 2001, only 1.5 percent of college graduates were counted among the working poor, compared with 5.8 percent of high school graduates (no college), and 13.1 percent of high school dropouts.[9]

The proportion of hourly workers earning minimum wages has trended downward since 1979, when data first began to be collected on a regular basis. This means that a far fewer percentage of workers today make the minimum wage than twenty years ago.

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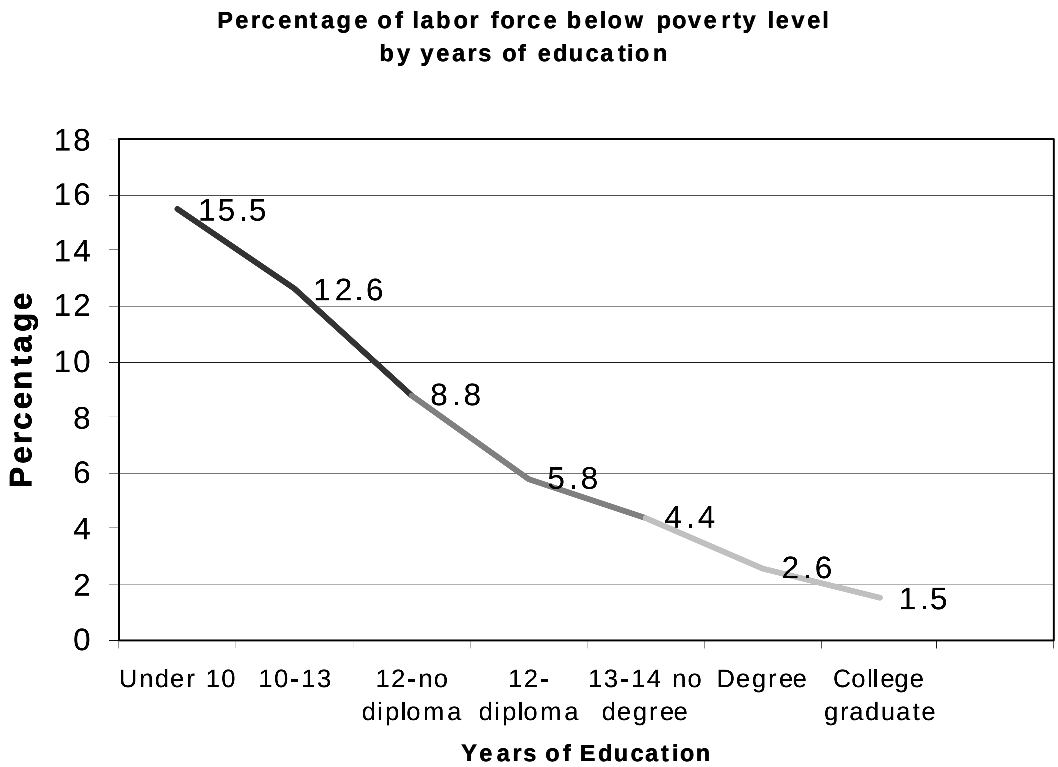
[8] Abraham T. Mosisa, "The working poor in 2001," *Monthly Labor Review*, November/December 2003, published by the Bureau of Labor Statistics.
[9] *Ibid.*



The data underscores the need to focus on other methods of helping the working poor than mandating higher wage floors. For example, improving the quality of public education would do more to lift people out of poverty, because most minimum wage earners are younger, in their teens and twenties, and without families, and are most likely continue to live at home or reside in a household where someone already holds a "living wage" job. Any potential income benefits from raising wage floors are likely to go to those who do not need it the most.

For most workers, earning the minimum wage is a temporary situation. A study in *Monthly Labor Review* points out that 63 percent of minimum wage workers were employed at higher-than-minimum wage jobs one year later. A similar study found that only 15 percent of minimum wage workers still had any minimum wage hours after three years. This suggests that, while it can happen, long-term minimum wage employment is rare.[10]

7. Living Wage Ordinances Force the Least Skilled Workers out of the Labor Market

A Public Policy Institute of California report, published in 2005, assesses ten years of LWOs and concluded that mandated wage ordinances:

[10] William J. Carrington and Bruce C. Fallick, "Do some workers have minimum wage careers?" *Monthly Labor Review*, May, 2001, published by the Bureau of Labor Statistics.

> "…boost the wages of the lowest-wage workers but at the cost of disemployment effects for the least skilled… The beneficial distributional effects of living wages are actually somewhat mixed – reducing poverty but not necessarily by helping the lowest-wage, lowest-skilled individuals."[11]

In other words, some households below the poverty line may see a bump in overall income, but a large majority of families that would benefit are not living in poverty to begin with.

In a living wage survey of some 360 labor economists across the United States, the University of New Hampshire Survey Center found that three-fourths of them believe that a national living wage would result in employers hiring better skilled applicants than they hired before the increase.

This trend would result in employment losses because the living wage requirement would price lower skill workers out of the labor market. Likewise, 93 percent of the labor economists surveyed believe a LWO is not an efficient way to address the income needs of poor families.[12]

Evidence shows that if wages are mandated at artificially high levels, higher-skilled workers will compete for those low-skill jobs. Employers will choose high-skilled workers over low-skilled workers for the same wage. Low-skilled and inexperienced workers are less likely to be pulled into a job market that pays higher mandated wages, when previously these same high wages went to higher-skilled, more-experienced employees.

This natural employer response to artificial wage mandates reduces the appeal of low-skill workers in the job market. This exacerbates the problem of the low-skilled, low-educated workers face – the whole reason why artificial wage mandates were implemented in the first place. A government may be able to mandate the minimum wage an employer must pay, but the government cannot mandate the number of hours worked by each employee.

A similar report points out that because a disproportionate number of minimum and low-wage workers are minorities and women, they will are hardest hit by the disemployment effects of an LWO. Particularly hard hit would be younger African American and Hispanic males.[13]

Another viable question to ask in determining whether or not an LWO will help raise workers out of poverty is, "Will an LWO have a larger effect than the combination of current minimum wage laws and existing state and federal poverty programs?"

After all, wages are only one element of a household's financial and economic position. Benefits provided by public and private social programs play an important role in a low-income household's economic standing.

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[11] Scott Adams and David Neumark, "A Decade of Living Wages, What Have We Learned?" *California Economic Policy*, Public Policy Institute of California, volume 1, number 3, July 2005.
[12] "The Living Wage: Survey of Labor Economists," Employment Policies Institute, August 2000.
[13] David Neumark, "Minimum Wage Effects in the Post-Welfare Reform Era," Employment Policies Institute, January, 2007.

In Washington state, the working poor have ready access to at least 14 forms of state and federal taxpayer-funded assistance. These programs include:

- Temporary Assistance for Needy Families (TANF)
- Working Connections Child Care
- General Assistance Unemployable (GAU)
- Low-cost or free health insurance for children
- Low-cost or free health insurance for families
- Basic Health Program
- Act for Hungry Families
- Child Nutrition Program (school lunches)
- Washington's Seamless Summer Feeding Program
- Food Stamp Program
- State "Energy Matchmaker" Program
- State Low Income Home Energy Assistance Program/Energy Assist. Programs
- Public Utilities discounts for low-income, seniors or disabled customers
- Federal Earned Income Tax Credit

This partial list gives just some of the state and federal programs set up to assist needy families. Many of these program participants are eligible based on the level of household earnings. Even though the goal of a working poor household is to eventually be free of these types of programs, one must consider the effect on a household's bottom line when an LWO may make them ineligible for these programs.

Several economists have studied the effects of proposed LWOs and pointed out that the combination of earnings from a minimum wage, along with the many federal and state income programs, provide a higher standard of living than the combination of a living wage, higher tax liability and lack of access to these programs.

A higher mandated wage floor, while notching up the earnings, makes many families ineligible to receive the benefits of many of these programs – and therefore the household is actually worse off because they are now having to pay for several benefits they did not have to before.[14]

8. Creating Job Opportunities

Instead, there are effective steps a government can take to help those in the working poor category. Ensuring a strong environment for economic growth and lowering the cost barrier to creating jobs will benefit low-skilled workers. Equally, if not more important, is to make sure that our educational system is top-notch. The research shows that those with higher education are much less likely to end up in a working poor household.

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[14] For more information, see "What's the Best Way to Help Low-Wage Workers Move Up?" by the Public Policy Institute of New York, April 2002 (http://www.ppinys.org). Also see "Distributional, Employment and Budgetary Effects of Living Wage Ordinances" by Robert P. Strauss, Employment Policies Institute (http://www.andrew.cmu.edu/user/rs9f/epi_living_wage_9_5_06_REVISED2.pdf).

Moving up the socioeconomic ladder entails access to starter jobs, jobs that may be forced out of the economy if public policy sets the starting labor costs artificially high. Simply mandating a higher wage to a specific industry does not necessarily help those workers who need it most.

9. Spokane's Retail Industry: More Work Experience Means Higher Wages

The city of Spokane's 200,000 residents live just 18 miles from the border of Idaho, where the minimum wage is pegged at the federal minimum wage ($5.85 an hour as of July 24th). This is important because any regulatory policy that increases the cost of conducting business in one particular region (Spokane), automatically gives a nearby region (Idaho) a competitive advantage.

Consumers will see that if the price of retail goods rises enough to negatively affect their disposable income, they will take certain steps to negate these effects. Shoppers would not even have to travel the 18 miles to the Idaho border to benefit from lower prices. All that consumers have to do is cross the city border, most likely to the City of Spokane Valley, which has grown dramatically during the past several years.

Spokane has 1,117 retail firms that together employ over 25,000 people. Only a handful of these firms would be affected by the LWO, but those few employ a majority of retail workers.

According to the state Employment Security Department, the average entry wage for a retail salesperson in Spokane is $8.67, almost 10 percent above minimum wage. As retail workers gains experience and skills, their wages increase.

The bottom 10 percent of retail salespeople in Spokane earns about $8.19 per hour, but the bottom 25 percent earns $9 per hour. The median Spokane retail salesperson's salary is $11.02 and once the salesperson starts accumulating even more experience and moving up in the business they earn even more. The 75th percentile earns $14.63 per hour and the top ten percent can make upwards of $23.57 per hour, or $49,025 per year.[15]

The mean wage (overall average) for early 2007 is $13.62 per hour, about five percent *above* what an LWO would mandate. The median wage is $11.02 per hour. This means that there is a greater likelihood that people in the retail sales positions will make less than $13.08 until they gain experience and work-related skills. As they do, they are likely to make far more than what the LWO would mandate.

[15] Information compiled from Employment Security Department's Labor Market and Economic Analysis Occupational Wages, Spokane MSA, Retail Trade, Retail Salesperson Wage Survey, May 2007.

Many jobs in the retail sector are, by-and-large, regarded as requiring lower skills and less experience in order to enter the labor market. But as in every industry, quality workers who perform well soon receive wage increases. As the cost of entry-level jobs increases, employers will look for starting employees with higher skillsets and experience in order to justify the higher cost of labor. This will increasingly deny access to work opportunities to two types of workers – teenagers and low-skilled workers.

The targets of the proposed LWO, large-scale retailers, are also much-maligned for a perceived practice of not offering health insurance to employees. A recent survey by the Employment Security Department shows this is not necessarily the case.

In the 2007 *Washington State Employee Benefits Report*, 60 percent of retail firms of all sizes offered medical insurance to full-time employees, and 40 percent offered dental insurance in addition to medical coverage. The survey shows that 90 percent of all full-time retail employees are offered medical insurance and 69 percent of employees in the retail trade are enrolled.

On the other hand, only seven percent of firms surveyed offered part-time workers medical insurance and only 3.8 percent offered dental insurance. This translated into 35 percent of part-time employees being offered medical and 55 percent of those offered it were enrolled.[16]

[16] "Washington State Employee Benefits Report," Employment Security Department, Labor Market and Economic Analysis Branch, released February 2007.

Two conclusions stand out from these numbers. Nine out of ten full-time retail workers are offered health care and almost seven out of ten take up the offer, whereas only fifty percent of the part-time retail workers take up the medical insurance offer.

So, not only are a vast majority of full-time retail workers offered health insurance, they accept it. And, there are a smaller percentage of part-time employees taking health insurance.

This suggests that the part-time retail workers, those who already make less and are offered fewer benefits, are much more likely to have another earner at home and possibly be covered on that earner's health insurance plan.

To say large retailers do not offer health insurance and pay very little is disingenuous. While not every employee makes above the mandated wage that LWO proponents desire, the industry provides entry-level jobs for younger workers who have few marketable skills. To assume a low-skilled, low-experienced worker could jump into the labor market and make a lot of money denies economic reality.

The truth is that most people start out making low wages, in any industry, until they gain experience. Once an employee gains experience while showing their productivity, they will make more than a minimum wage.

10. True Impact

Public policy should be debated on the merits of a cost/benefit analysis. Obviously, if there were only benefits to mandating wage floors, there would be many more of them. The reason more wage floors do not exist in Washington and across the country is because it is a price control on labor. Mandated wages carry very distinct economic and social costs, and for the most part the costs outweigh the benefits.

Likewise with a city or region-wide LWO; there is a benefit and a cost to implementing such a provision – and usually the cost is prohibitive. So, referencing some of the other examples from around the nation, what could the effect of an industry LWO have on the Spokane region?

11. Job Losses Due to Mandated Wages

Many studies have run complex econometric modeling to determine the true impact upon employment in LWO jurisdictions. There is no single agreed-upon determining scale, but all of them agree that an LWO results in lost jobs and decreased employment.

Most reports assume a negative 0.1 to negative 0.2 labor elasticity for every 10 percent increase in the minimum wage. In other words, each 10 percent increase in the mandated minimum wage results in a decrease in employment of one to two percent for low-skilled workers.

Extrapolating this equation for an LWO that would increase the minimum wage on the large retail industry by 35 percent means that employment for low-skilled workers would drop from between 3.5 percent to seven percent.[17] Using the state's estimated number of 25,000 retail employees in the Spokane area, this could result in a net loss of 875 to 1,750 retail-oriented jobs.

12. Fewer Working Hours and the Effect on Small Businesses

It is important to remember, however, that these elasticity numbers do not encapsulate the possible effect on hours worked. This means that an unintended consequence of mandated wage increases is that low-skilled workers may see their hours cut back. So, while some workers might make more money per hour, the net affect of the mandated higher wage combined with fewer working hours could result in no change in take-home pay or a financial loss for workers.

One of the immeasurable economic impacts is the impact an LWO would have on a small retailer or a boutique store. Evidence shows that a retail employee stands a better chance of being offered health insurance if working for a larger retail business. If the large retail business is now forced to provide a living wage, that business, as stated previously, will look for a worker with more experience and skills.

This effect will tend to draw high quality workers away from small retailers who do not already pay the equivalent of a living wage. Small retailers would be forced to recruit workers from a lower skill level pool of job applicants. This does nothing to alleviate poverty, and increases the chances that small retailers will be forced out of business.

13. The Effect of Price Controls on Labor Demand and Supply

Though it is not mentioned in the public debate, a mandated floor on wages (e.g. minimum wage, living wage or other) is a price control on labor. Any time a governmental body interferes in a market to set prices, it ends up affecting the supply (available labor) and demand (available jobs) of the market.

Price controls are not new. Various forms of government, democratic and otherwise, have used price controls to fix prices from ancient times to the present day. In the case of living wages, supporters are pushing the government to fix the price of labor.

This is a natural human impulse – after all, how can one person judge what another is worth? But therein lies a grave misconception. Employers do not, and should not, judge what an employee is worth as a person, but rather, what their time, labor and productivity are worth. This is why someone of the same age, race, sex and background as another may be compensated differently. It is not that one person is intrinsically better, or worse, than another, but rather that one person may be paid at a higher rate because he is a more productive employee.

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[17] "The Economic Impact of Mandated Wage Floors," David Neumark, Public Policy Institute of California, 2004.

Price controls are often a habitual reaction to a market fluctuating faster than policymakers can understand. The reactionary first instinct is to immediately manipulate the marketplace so as to "protect" consumers. Unfortunately, these price controls often have unintended consequences that end up harming consumers rather than helping them.

Price controls distort the allocation of economic resources. Price ceilings cause shortages. Price floors cause surpluses. As a price control on employment, an LWO causes a surplus of labor and a shortage of jobs.

The demand for a mandated high-wage job will increase rapidly, but the cost of those jobs will shrink the available supply of paid work (employment opportunities). Workers lucky enough to get the mandated high-wage jobs will most likely be better off. The social price, however, will make it tougher for all those without jobs to break into the ranks of the employed.

The problem with price controls as public policy is that the public usually does not see the relationship between the controls and the unintended consequences they create, in this case, high unemployment for low-skilled workers.

14. Constitutionality of LWOs and ERISA Violations

Even though localities have passed over 100 LWOs throughout the nation, most of those apply only to contracts between city or county governments and private contractors. However, with the proliferation of LWOs that focus on the general practices of a private business, several possible legal ramifications arise.

The Employee Retirement Income Security Act (ERISA) is a federal law that sets minimum standards for most voluntarily-established pension and health plans in private industry to provide protection for individuals in these plans. ERISA is where benefits-related programs such as COBRA and HIPAA originated.

Under ERISA, multi-state companies (like Home Depot or Target) are able to maintain nationwide health and welfare plans that provide uniform health and welfare benefits and cost-effective national administration of these benefits. Target's employee benefit program in Maryland can be the same as in Washington. Target can make improvements in a plan on a state-by-state basis, but a state or locality is prohibited from telling an employer how to run its benefit plan.

In July 2006, a federal judge overturned a Maryland law that would have forced large private companies to spend a certain percentage of company payroll on employee health plans. The judge ruled that Maryland's law would have "…violate[d] ERISA's fundamental purpose of permitting multi-state employers to maintain nationwide health and welfare plans…"[18]

The same judge cited two earlier ERISA challenge cases that underscores the point that ERISA is designed, "to avoid a multiplicity of regulation in order to permit the nationally

[18] *Retail Industry Leaders Association v. Maryland*, Civil No. JFM-06-316.

uniform administration of employee benefit plans," and, "uniformity is impossible, however, if plans are subject to different legal obligations in different states."[19]

In the same ruling, the judge cites long-standing Supreme Court law that state laws which impose employee health or welfare mandates on employers are invalid under ERISA.

Because of the LWO's split options – a lower wage that includes health insurance or a higher wage without – it is unclear how ERISA law would affect it. It is possible that a court could throw out the mandated benefits portion of the LWO because states are not allowed to directly mandate employer health coverage.

Chances were strong that if Spokane's proposed LWO were passed by voters, it would have been challenged in court under the ERISA law. Until an LWO that targets private employers (such as Spokane's) is tested in court, the legal viability of a state or local LWO remains uncertain.

15. The Philosophy of "Need"

Proponents of living wage ordinances and minimum wage increases are attempting to answer an age-old question: How can the working poor be raised above their current plight of subsistence living? Increasing the mandated wage floor (the minimum wage) is commonly thought to provide immediate help to the working poor. More money in the pockets of the working poor is sure to help turn around their economic woes, right?

Wrong. As discussed above, most minimum wage earners do not live in poverty, and increasing the cost of providing an entry-level job tends to price out inexperienced and low-skilled workers, the very people the minimum wage policy is supposed to help. This negative effect on job creation is even stronger in the living wage ordinances, since an LWO is simply a super-minimum wage.

The philosophy behind the living wage is that the working poor should be paid based on their needs, rather than on the economic value of the work they provide for their employer. Using personal need to define wages is a veiled attempt to criticize the fairness of the free market labor system, on which just about every other wage in the economy is determined.

This approach ignores the equality and fairness that is inherent in the free market: each employee is paid according to the value of the time and effort he contributes in the workplace. What is unfair is to impose a law that makes employers pay a worker who provides less-valuable work the same amount an employees who contributes more valuable work. It is also unfair to impose an arbitrary wage policy, one that has nothing to do with economics, that denies work opportunities to inexperienced and low-skilled workers.

LWO proponents argue that a certain standard of living should be guaranteed by the government and that no one should fall below this standard. So, according to the Northwest

[19] http://www.dol.gov/dol/topic/health-plans/erisa.htm

Federation of Community Organizations, a full-time worker in King County with two children should receive a wage of $25.99, regardless of the true value of his economic contribution in the workplace.

This mandated-wage policy would produce an income of $54,059 per year. In contrast, the average income in King County in 2004 was $49,286. In Spokane, the same household should receive $20.65 an hour, or an annual income of $42,952.[20]

Using the same needs-based reasoning, a part-time worker who has the same household, a single adult with two children, has the same needs as a full-time worker in the same situation. Therefore, the reasoning of LWO proponents suggests that the law should require the wage of the part-time worker to rise to meet his needs.

The proposed Spokane LWO would make any retail worker working more than 16 hours per week eligible for the living wage. Therefore, according to proponents' needs-based reasoning, a part-time employee in Spokane working 16 hours a week should receive a wage of $51.63 per hour. In King County the same part-time worker should receive $64.97.

There is little doubt that most policymakers, employers, and even employees recognize the absurdity of setting wages based on such reasoning.

16. Conclusion

Helping the working poor achieve financial independence is a noble public policy goal and one that should be taken seriously. In one of the most prosperous nations ever, as well as one offering the most opportunities to its citizens, people who work hard and respect the law should generally expect to make ends meet. Through whatever circumstances, however, not everyone is going to achieve those goals.

Implementing a living wage ordinance is, unfortunately, not the answer to the fundamental problem of, "How can we help the working poor?" The research shows that a top-down mandated wage floor tends to help those that do not need the assistance, while harming those it is intended to help.

> *"From each according to his abilities, to each according to his needs."*
> 1936 Soviet Constitution

As shown by other proposals throughout the nation, the effect of an LWO on city or municipal finances could be substantial. Basic economic principles show that as the cost of conducting business increases, an employer will take steps to mitigate those costs.

In the case of a large increase in labor costs imposed in the form of a mandatory LWO, the mitigating steps open to business owners include:

[20] For more information, see King and Snohomish county fact sheets in "*Living Wage Jobs in the Current Economy*: *2006 Washington Job Gap*" at http://www.nwfco.org/job_gap.htm

- Relocating the business;
- Laying off employees;
- Canceling expansion plans;
- Reducing employee benefits;
- Passing higher costs on to consumers (if market conditions allow it);
- Going out of business.

All these actions, in some form, come back to harm the worker that the living wage law is intended to assist.

On the philosophical and policy standpoint, establishing a mandatory wage based on the need, instead of the productivity, of an employee steps all over traditional and time-tested basic economic practices. The natural equilibrium of remuneration for time and labor is upset when a powerful third party (government) institutes price controls on labor. This results in a substitution effect; employers seek ways to control rising costs, resulting in low-skilled or low-educated employees being priced out of the labor market.

Living wage ordinances, while bringing a benefit to employees who are fortunate enough to remain employed, are detrimental to those without jobs and to the business climate in general.

Intervention by government through regulation and taxation can have a positive or negative effect on an economy. When government uses its authority to mandate wage floors that are above the labor market equilibrium the effects are primarily negative. The policy forces employers to take on higher wage costs, increase prices or reduce jobs and work hours, or some combination of all three. The overall results of an economic policy that includes a living wage ordinance are lost productivity for employers, higher prices for consumers and lost job opportunities for workers.

About the Author

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