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The Economic Effects of Mandated Wage Floors

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Summary

Minimum wages and, more recently, living wages have been introduced in the United States to attempt to reduce poverty, or more generally to assist low-income families, by increasing incomes of families at the bottom end of the income distribution. The federal minimum wage currently stands at $5.15, and coverage is nearly universal. In addition, numerous states have at times imposed higher minimum wages, typically for the same workers covered by the federal minimum wage. Living wage laws are a much more recent innovation, with the first one passed in 1994 and nearly 100 cities and other jurisdictions following suit since then. Living wage laws impose wage floors that are much higher than federal and state minimum wages but typically entail much more restrictive coverage; cities frequently impose wage floors only on companies under contract with the city, but many also impose the wage floor on companies receiving business assistance from the city.

The central policy goal of both minimum wages and living wages is to raise incomes of low-wage workers so as to reduce poverty. Although mandating higher wages for low-wage workers may strike a noneconomist as a natural way to fight poverty, there are two reasons why higher mandated wages may not help to achieve this goal. First, mandated wage floors may discourage the use of low-skilled labor, operating essentially as a tax on the use of such labor. Thus, whatever wage gains accrue to workers whose employment is unaffected may have to be offset against job losses for some workers. Second, mandated wage floors may ineffectively target low-income families, because many low-wage workers are in fact in high-income families.

This paper summarizes evidence on the employment and distributional effects of minimum wages and living wages and discusses some of the differences between the two types of mandated wage floors. It also briefly discusses these issues in light of the latest innovation in mandated wage floors—city minimum wages that extend a higher wage floor to essentially all workers within a city.

The evidence indicates that both minimum wages and living wages reduce employment of low-skilled workers, thus confirming the criticism of mandated wage floors that is most commonly voiced in debates over these wage floors. Furthermore, minimum wages deliver no net benefits to poor or low-income families and, if anything, make them worse off. On the other hand, the distributional effects of living wages are more salutary, because living wages reduce urban poverty, although this evidence does not imply that living wages are the most effective means of reducing poverty. Among other concerns regarding living wages, their adverse employment effects on low-skill individuals suggest that living wages may reduce poverty without necessarily helping the lowest-wage workers.

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Introduction

A number of policy proposals and initiatives have been used in the United States to attempt to reduce poverty, or more generally to assist low-income families, by increasing incomes of families at the bottom end of the income distribution. My research over the past decade or so has focused on studying the effectiveness of two policies that attempt to accomplish this by mandating higher wages for low-wage workers: minimum wages and living wages.

Minimum wages were first established on a national level with the Fair Labor Standards Act of 1938. Although coverage was initially quite restrictive, it is now nearly universal. The federal minimum currently stands at $5.15. Numerous states have at times imposed higher minimum wages, typically for the same workers covered by the federal minimum, but with some exceptions. The highest state minimum wages currently are in Washington ($7.16), Alaska ($7.15), Connecticut ($7.10), Oregon ($7.05), and California, Massachusetts, Rhode Island, and Vermont ($6.75).[1]

Living wage ordinances are a much more recent innovation. Baltimore was the first city to pass such legislation, in 1994, and nearly 100 cities and other jurisdictions have followed suit.[2] Living wage laws have three central features. First, they impose a wage floor that is higher—and often much higher—than traditional federal and state minimum wages. Second, living wage levels are often explicitly pegged to the wage level needed for a family with one full-time, year-round worker to reach the federal poverty line. Typical living wage levels are $7.72 (Los Angeles), $8.83 (Detroit), and $10.25 (Boston). Third, coverage by living wage ordinances is highly restricted. Frequently, cities impose wage floors only on companies under contract (generally including nonprofits) with the city. Other cities also impose the wage floor on companies receiving business assistance from the city, in almost every case in addition to coverage of city contractors. Finally, a much smaller number of cities also impose the requirement on themselves and pay city employees a legislated living wage.

The central policy goal of both minimum wages and living wages is to raise incomes of low-wage workers so as to reduce poverty. Senator Edward Kennedy, a perennial sponsor of legislation to increase the minimum wage, has been quoted as saying "The minimum wage was one of the first—and is still one of the best—antipoverty programs we have" (quoted in Clymer, 1999, p. 449). Similarly, the Economic Policy Institute, while noting that other anti-poverty tools are needed, argues that "the living wage is a crucial tool in the effort to end poverty."[3] Thus, although there is generally no single measure with which the distributional effects of a policy can be unambiguously assessed, and although overall welfare effects are much more complicated, evaluating the impact of mandated wage floors on poverty is a reasonable means of assessing the success of these wage floors.

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[1] See the U.S. Department of Labor's web site, http://www.dol.gov/esa/minwage/america.htm, for details on state minimum wages.

[2] See http://www.epionline.org/livingwage/index.cfm, the web site of the Employment Policies Institute, for up-to-date details on living wages.

[3] See www.epinet.org/Issueguides/livingwage/livingwagefaq.html.

While mandating higher wages for low-wage workers may strike a noneconomist as a natural way to fight poverty, there are two reasons why they may not help to achieve this goal. First, standard economic theory predicts that a mandated wage floor will discourage the use of low-skilled labor, operating essentially as a tax on the use of such labor. Thus, whatever wage gains accrue to workers whose employment is unaffected may have to be offset against potential job losses for some workers. Second, mandated wage floors may ineffectively target low-income families. Broadly speaking, low-wage workers in the United States belong to two groups. The first is very young workers who have not yet acquired labor market skills, but who are likely to escape low-wage work as skills are acquired. The second is low-skilled adults who are likely to remain mired in low-wage work (Carrington and Fallick, 2001), and who—as adults—are much more likely to be in poor families. To the extent that the gains from mandated wage floors accrue to low-wage adults and the losses fall on low-wage, nonpoor teenagers, mandated wage floors may well reduce poverty. But there is no theoretical reason to believe that this outcome is more likely than the reverse, with concomitant adverse outcomes for low-income families. Thus, although theory predicts employment losses and hence implies that there are likely to be both winners and losers from mandated wage floors, the distributional effects of mandated wage floors is a purely empirical question.

This paper discusses each of these issues in the context of both minimum wages and living wages. The next section discusses some general economic issues regarding mandated wage floors, focusing on the potential disemployment effects of minimum wages or living wages and how economists measure such effects. The following two sections present evidence on the employment and distributional effects of minimum wages and living wages, and discuss some of the differences between living wages and minimum wages. The penultimate section briefly discusses the latest innovation in mandated wage floors—city minimum wages. The final section draws conclusions from the foregoing discussion.

The Economics of Mandated Wage Floors

The textbook economic theory of the effects of mandated wage floors is straightforward. In the textbook treatment, there is a competitive labor market for a single type of labor, for which there is an upward-sloping aggregate labor supply curve and a downward-sloping aggregate labor demand curve. Prior to the imposition of the wage floor, there is an equilibrium price of labor w and an equilibrium quantity of labor employed L. If the wage floor w_f is set at a wage higher than w—so that the minimum wage is "binding"—then employers reduce their use of labor for two reasons. First, there is a substitution effect leading employers to use relatively less of the now-more-expensive labor and relatively more of other inputs (such as capital) in an effort to find a new cost-minimizing input mix. Second, because costs must be higher with this new input mix (otherwise employers were not previously minimizing costs), the prices of the products firms produce must rise. This, in turn, reduces demand for each firm's product, leading to a reduction in the scale of operation. Consequently, both this scale effect and the substitution effect lead to lower employment, say at the level $L_f < L$.

In the extensive research literature on minimum wages (and the newer literature on living wages), employment effects are typically summarized in terms of the "employment elasticity." The employment elasticity is the ratio of the percent change in employment to the percent change in the wage induced by the wage floor, or in the above example:

Employment elasticity = $\{(L_f - L)/L\} / \{(w_f - w)/w\}$.

This summary measure is convenient because it can be used to predict the percent change in employment resulting from a given percent change in the mandated wage floor. Thus, for example, an elasticity of −0.1 implies that a 10 percent increase in the wage floor reduces employment by 1 percent. Of course, one can also define elasticities of other outcomes, such as the elasticity of wages with respect to the minimum wage.

It is important to emphasize that the simple textbook model of the effects of wage floors is just that—only a model. That the model predicts disemployment effects does not imply that minimum wages must reduce employment, because the model may not provide a sufficiently rich description of the labor market. Thus, at best it leads to a prediction that should be tested with data. At the same time, the prediction that a higher mandated wage floor reduces employment is based on a core tenet of the neoclassical economic model—that demand curves slope downward. This may explain why some of the evidence discussed in the next section suggesting that minimum wages do not reduce employment generated such a firestorm among economists.

Staying within this market-based perspective on labor markets, there are two potential explanations for why wage floors may not produce detectable declines in employment, or may even in some cases increase employment. The first explanation is simply that labor is more heterogeneous than suggested by the simple textbook model. When there are different types of labor differentiated by skill level, employers may substitute from one type of labor to another; for example, employers may make less use of the least-skilled labor that has been made more expensive because of the mandated wage floor, and instead make more use of higher-skilled labor whose wage is not directly affected by the mandate. In this case, even though overall employment is still predicted to decline, possibilities for substitution among labor types will moderate the disemployment effects—possibly substantially—and if we focus on subgroups of workers, employment may not fall at all or could increase. For both reasons, disemployment effects of wage floors may be difficult to detect statistically.[4]

The second explanation appeals to monopsony power in the labor market—or simply market power on the part of employers. In a competitive labor market, employers are assumed to be small relative to the market and hence can hire all the labor they want at the existing wage. In a classic monopsony model, in contrast, employers are large relative to the labor market and hence must pay higher wages to attract more employees, and because they cannot pay different wages to similar workers, increasing employment ends up raising wages for many of their workers. The implication of this is that when an employer wants to hire more labor, the cost of doing so is higher than the wage required to attract a new worker, leading employment to be

[4] See Neumark and Wascher (1996) for a summary of these arguments and related evidence.

lower than in a competitive labor market.[5] In this case, a mandated wage floor higher than the equilibrium monopsony wage, but not too high, can increase employment by breaking the link between the wage and the marginal cost of labor curve, because up to a point, each additional worker simply gets the minimum wage. This argument was originally offered by Stigler (1946), although he was skeptical of government's ability to predict the wage floor that would actually increase employment.[6]

Minimum Wages

Labor economists have written innumerable papers testing the prediction that minimum wages reduce employment. Earlier studies used aggregate time-series data for the United States to estimate the effects of changes in the national minimum wage. The consensus view from these "first generation" studies was that the elasticity of employment of low-skilled (young) workers with respect to minimum wages was most likely between −0.1 and −0.2; that is, for every 10 percent increase in the minimum wage, employment of low-skilled individuals falls by 1 to 2 percent.[7]

More recent studies have used panel data covering multiple states over time, exploiting differences across states in minimum wages. This approach permits researchers to abstract from aggregate economic changes that may coincide with changes in the national minimum wage and hence make untangling the effects of minimum wages difficult when using aggregate time-series data. (See, e.g., Card, 1992a and 1992b; Williams, 1993; and Neumark and Wascher, 1992.) Evidence from these "second generation" studies has spurred considerable controversy regarding whether or not minimum wages reduce employment of low-skilled workers, with some researchers arguing that the predictions of the standard neoclassical model are wrong, and that minimum wages do not reduce and may even increase employment.

The most prominent and often-cited such study uses data collected from a telephone survey of managers or assistant managers in fast-food restaurants in New Jersey and Pennsylvania before and after a minimum wage increase in New Jersey (Card and Krueger, 1994). Not only do these data fail to indicate a relative employment decline in New Jersey, but instead they indicate that employment rose sharply there (with *positive* employment elasticities in the range of 0.7).

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[5] Formally, this occurs because a profit-maximizing employer hires up to the point where the marginal cost of labor equals the marginal revenue product, and monopsony raises the marginal cost of labor above the wage.

[6] More modern versions of monopsony models based on labor market frictions are presented in Manning (2003). The driving force behind monopsony—increased costs of employment of the existing workforce when a new worker is hired—can also arise from a need to supervise workers (Lang, 1987) and in workplaces with tipped employees (Wessels, 1997).

[7] For a review of the earlier time-series studies see Brown et al. (1982). Results extending this research through the mid-1980s and finding more modest effects are reported in Wellington (1991). A more recent time-series study using data through 1993 and employing more sophisticated tools of time-series analysis finds stronger disemployment effects (Williams and Mills, 2001).

On the other hand, much recent evidence using similar sorts of data tends to confirm the prediction that minimum wages reduce employment of low-skilled workers (Burkhauser, et al., 2000; Zavodny, 2000), as does earlier work with a much longer panel of states (Neumark and Wascher, 1992).[8] Moreover, an approach to estimating employment effects of minimum wages that focuses more explicitly on whether minimum wages are high relative to an equilibrium wage for affected workers reveals two things: first, that disemployment effects appear when minimum wages are more likely to be binding (because the equilibrium wage absent the minimum is low); and second, that some of the small or zero estimated disemployment effects in other studies appear to be from regions or periods in which minimum wages were much less likely to have been binding (Neumark and Wascher, 2002). Finally, a reexamination of the New Jersey-Pennsylvania study that I conducted, based on payroll records collected from fast-food establishments, finds that the original telephone survey data were plagued by severe measurement error and that better payroll data generally point to negative employment elasticities.[9]

Across this array of more recent evidence, the estimated effects often parallel the earlier time-series research indicating that the elasticity of employment of low-skilled workers with respect to the minimum wage is in the −0.1 to −0.2 range, with estimates for teenagers (who have often been the focus of minimum wage research) closer to −0.1. As further evidence, a leading economics journal recently published a survey including economists' views of the best estimates of minimum wage effects. Results of this survey, which was conducted in 1996—after most of the recent research on minimum wages was well-known to economists—indicated that the median "best estimate" of the minimum wage elasticity for teenagers was −0.1, while the mean estimate was −0.21 (Fuchs et al., 1998). Thus, although there may be some outlying perspectives, economists' views of the effects of the minimum wage are centered in the range of the earlier and many of the more recent estimates of the disemployment effects of minimum wages.

Although the research on disemployment effects appears to settle (for many, at least) a question regarding the labor demand effects of mandated wage floors, it does not answer the question of whether minimum wages raise incomes of low-wage workers, or more importantly of poor or low-income families. It is often argued that an employment elasticity as small as −0.1 or −0.2 implies that minimum wage increases must raise incomes of low-wage workers, because the elasticity is much smaller (in absolute value) than −1 (for example, Freeman, 1996). However, these elasticity estimates do not necessarily capture the relevant parameter, which is the elasticity of the demand for minimum wage labor with respect to the minimum wage, ignoring the possibility that the employment effects are sharpest for those at the minimum wage. In addition, these estimates pay no regard to possible hours effects, and use the legislated minimum wage change—rather than the typically smaller actual wage change induced by a minimum wage increase—in the denominator. In the other direction, this calculation also ignores possible wage increases for workers above the minimum wage. Although these considerations suggest that the elasticity is closer to −1, they do not necessarily imply that the elasticity is actually that large; on the other hand, in principle it could be even

[8] See also the exchange on the evidence in this paper in Card et al. (1994) and Neumark and Wascher (1994).

[9] See Neumark and Wascher (2000) and the reply in Card and Krueger (2000).

larger. The critical point, though, is that the effects of minimum wages on low-wage workers must be studied directly. Back-of-the-envelope calculations based on employment elasticities estimated for different purposes cannot pin down these effects.

Turning first to low-wage workers, I have recently examined the effects of minimum wages on employment, hours, wages, and, ultimately, labor income of workers at different points in the wage distribution (Neumark et al., forthcoming). This research indicates that workers initially earning near the minimum wage are on net adversely affected by minimum wage increases, while, not surprisingly, higher-wage workers are little affected. While wages of low-wage workers increase, their hours and employment decline, and the combined effect of these changes is a decline in earned income among workers initially earning the minimum wage. For these workers, the hours elasticity is in the range of −0.2 to −0.25, the employment elasticity in the range of −0.12 to −0.17, and the earned income elasticity is approximately –0.6.

Finally, in turning to the key distributional question—the effects of minimum wages on low-income families—we must keep in mind the imperfect mapping between low-wage workers and low-income families. Specifically, while there are few poor or low-income families with high-wage workers, there are many high-income families with low-wage workers. Table 1 illustrates this point. This table looks at family income-to-needs ratios and the presence of low-wage workers in families in 1989 (based on March 1990 Current Population Survey data), and how these families would be affected by the April 1990 increase in the federal minimum wage; poverty is defined as income-to-needs less than one. The calculations simply ask where workers likely to have their wages raised by the 1990 minimum wage are in the distribution of family income-to-needs, and hence effectively assume a "best-case" scenario of no disemployment effects. The table reveals that, not surprisingly, minimum wage workers are overrepresented at the bottom of the income distribution. For example, 22 percent of potentially affected workers (defined as those between the previous minimum and the 1990 minimum) are in poor families, and 35 percent are in poor or near-poor families. At the same time, many of the affected workers are in families with higher income-to-needs. The highlighted rows indicate that the share of minimum wage workers in families with income-to-needs greater than 3 (32.8 percent) is roughly equal to the share in poor or near-poor families (35 percent), suggesting that the benefits of minimum wages are approximately evenly split between low-income and higher-income families. Reflecting the weak link between low-wage workers and low-income families, Card and Krueger, who write quite favorably about minimum wages, acknowledge that, "The minimum wage is evidently a "blunt instrument" for redistributing income to the poorest families" (1995: 285).

The only way to directly answer the question of whether minimum wages help poor or low-income families is to look at the evidence directly. While the literature on minimum wages has emphasized employment effects, recent research has turned to the distributional question (Neumark et al. 2002). Evidence based on very flexible estimates of changes in the income-to-needs distribution associated with minimum wage increases is reported in Table 2. The figures reported in the table suggest that the proportions of families in poverty or near-poverty (income-to-needs less than 1.5) tend to rise following minimum wage increases, offset by declines in the proportion of families above the poverty line, in the 1.5 to 3 income-to-needs

range.[10] These results provide no basis for concluding that minimum wages reduce the proportion of families living in poverty or near-poverty and, if anything, indicate that minimum wages increase poverty. Thus, the combined evidence indicates that minimum wages do not appear to accomplish their principal policy goal of raising incomes of low-wage workers or of poor or low-income families.

One qualification to keep in mind is that this research tends to focus on the short-run effects of minimum wages, typically looking at effects at most a year after minimum wage increases. I am presently working on estimating the longer-run effects of minimum wages. But two sets of existing findings point to some potentially longer-lasting adverse effects of minimum wages—effects that extend beyond disemployment effects to those who work. First, minimum wages tend to reduce school enrollments of teenagers, at least where these enrollments are not constrained by compulsory schooling laws (Neumark and Wascher, 2003; Chaplin et al., 2003). Second, extending earlier research on the relationship between minimum wages and on-the-job training, a recent study I completed finds that minimum wages reduce training that is intended to improve skills on the current job (Neumark and Wascher, 2001a). Thus, minimum wages may reduce the human capital accumulation that leads to higher wages and incomes.

Living Wages

A much newer "front" in efforts to raise incomes of low-wage workers is the living wage campaigns that have brought living wage laws to nearly 100 cities (and other jurisdictions) since the first such law passed in Baltimore in 1994, with campaigns under way in many more cities. I have recently completed two studies (Neumark and Adams, 2003a and 2003b) that analyze the effects of living wage laws on low-wage workers and low-income families (see also Neumark, 2002).

The research begins by asking whether there is evidence that living wage laws lead to detectable increases in wages at the lower end of the wage or skill distribution. While such effects are readily detectable with respect to minimum wages, the question arises with respect to living wages because of the low fraction of workers covered, and because of questions about enforcement.[11] To estimate the impact on wages, the effects of living wages are identified from comparing changes in labor market outcomes in cities passing living wages with cities that do not pass such laws, paralleling the second-generation minimum wage research that identifies the effects of minimum wages by comparing changes in the same time period in states that did and did not increase the minimum wage. The same strategy is used in the estimation of other effects of living wage laws, discussed below.

As reported in the first column of Table 3, the evidence points to sizable effects of living wage laws on the wages of low-wage workers in the cities in which these laws are enacted. In fact, the magnitude of the estimated wage effect (an elasticity of approximately 0.07 for workers

[10] For a recent complementary approach, see Golan et al. (2001).
[11] For some preliminary information on enforcement of living wage laws, see Sander and Lokey (1998).

in the bottom tenth of the wage distribution) is much larger than would be expected based on the apparently limited coverage of city contractors by most living wage laws. Additional analyses reported in the table, which help to reconcile this large effect, indicate that the effects are driven by cities in which the coverage of living wage laws is broader—namely, cities that impose living wages on employers receiving business assistance from the city. For these business assistance living wage laws, the estimated elasticity of wages in the bottom tenth of the wage distribution is approximately 0.1, while for contractor-only living wage laws the estimated elasticity is indistinguishable from zero. While the 0.1 elasticity may suggest a small impact, it is an average wage increase experienced by low-wage workers, whereas the actual consequence would most likely be a much larger increase concentrated on a smaller number of workers directly affected by the living wage law.

As with minimum wages, the potential gains from higher wages may be offset by reduced employment opportunities. The evidence reported in the second column of Table 3 indicates that living wages do entail disemployment effects. The point estimate of −0.056 reported there implies an employment elasticity of about −0.14. More important, the estimated disemployment effect is a bit bigger and statistically significant precisely for the workers and type of living wage law for which there are positive wage effects—in particular, for low-skill workers covered by the broader laws that apply to employers receiving business assistance. Thus, as economic theory would lead us to expect, living wage laws present a trade-off between wages and employment.

This sets the stage for weighing these competing effects, in particular examining the effect of living wage laws on poverty in the urban areas in which they are implemented. Overall, the evidence in the third and fourth columns of the table suggests that living wages may be successful at reducing urban poverty in the cities that have adopted such legislation. The estimate in the third column indicates that living wages significantly reduce the probability that family earnings fall below the poverty line, and the estimate in the fourth column indicates that they significantly reduce the probability that total family income falls below the poverty line. Paralleling the findings for wage and employment effects, the impact on poverty arises only for the broader living wage laws that cover employers receiving business assistance from cities. The overall estimate in the fourth column implies an elasticity of the proportion of poor families with respect to the living wage of about −0.19. This seems like a large effect, given a wage elasticity for low-wage workers of less than 0.1. Of course no one is claiming that living wages lift a family from well below the poverty line to well above it. But living wages may help nudge a family over the poverty line, and we have to recall that these average wage effects are likely to be manifested as larger gains concentrated on a possibly quite small number of workers and families. Thus, even coupled with some employment reductions, living wages can lift a number of families above the poverty line.

In interpreting this evidence, it is important to keep two things in mind. First, while economic theory predicts that raising mandated wage floors will lead to some employment reductions, it makes no predictions whatsoever regarding the effects of living wages on the distribution of family incomes, or on poverty specifically. The distributional effects depend on both the magnitudes of the wage and employment effects (and other effects), and on their incidence throughout the family income distribution. Second, and following from this same point, there is no contradiction between the evidence that living wages reduce poverty and the

evidence that minimum wages increase poverty. The gains and losses from living wages may be of quite different magnitudes, and fall at different points in the distribution of family income, than do the gains and losses from minimum wages; this depends in part on the types of workers who are affected by these alternative mandated wage floors. Obviously, though, an important area for future research is to parse out the wage and employment effects of minimum wages and living wages at different points in the distribution of family incomes.

Of course a finding that living wage laws reduce poverty does not necessarily imply that these laws increase economic welfare overall (or vice versa). Living wage laws, like all tax and transfer schemes, generally entail some inefficiencies that may reduce welfare relative to the most efficient such scheme. Finally, there is another reason to adopt a cautious view regarding living wages. As already noted, the effects of living wages appear only for broader living wage laws covering employers receiving business assistance. The narrower contractor-only laws tend to have no detectable effects. This raises a puzzle. Why, despite the antipoverty rhetoric of living wage campaigns, do they often result in passage of narrow contractor-only laws that cover a very small share of the workforce and do not benefit low-wage workers and low-income families?

One hypothesis I have explored (Neumark, 2001) is that municipal unions work to pass living wage laws as a form of rent-seeking. Specifically, by forcing up the wage for contractor labor, they reduce or eliminate the incentive for cities to contract out work done by their members, and in so doing increase the bargaining power of municipal unions and raise wages of their members. There is ample indirect evidence consistent with this, as municipal unions are strong supporters of living wage campaigns; for example, the American Federation of State, County, and Municipal Employees was one of the major organizers of the Baltimore living wage campaign (Osterman et al., 2001).

As further evidence, I explored the impact of living wage laws on the wages of lower-wage unionized municipal workers (excluding teachers, police, and firefighters, who do not face competition from contractor labor). The results are summarized in Table 4. The estimate in the first column indicates that these workers' wages are indeed boosted by living wages, with an elasticity of 0.16. The other columns, in contrast, show estimated effects of living wages on groups for which, under the rent-seeking hypothesis, no effects should appear (such as other city workers, or teachers, police, and firefighters), whereas under other scenarios—such as living wage increases being associated with rising city wages generally—such effects might appear. The fact that there are no significant positive estimates for other groups of workers bolsters the likelihood that living wages boost wages of unionized municipal workers by increasing rents. While there are other explanations of why unionized municipal workers might support living wage laws, or why these laws are so often narrowly circumscribed, direct gains to unionized municipal workers would appear to be rather telling evidence of rent-seeking behavior.

In sum, even if living wage laws have some beneficial effects on the poor, this last evidence suggests that they may well be driven by motivations other than most effectively reducing urban poverty. This does not imply that living wages cannot be an effective antipoverty policy. But it certainly suggests that living wages deserve closer scrutiny before choosing to implement them to combat poverty.

City Minimum Wages

The latest innovation among mandated wage floors is citywide minimum wages. City minimum wage proposals have been rare. Proposals were defeated in Houston in 1997, Denver in 1996, and Santa Monica in 2002.[12] In 2002, New Orleans tried to impose a minimum wage $1 higher than the federal minimum, but it was struck down in court. More recently, however, Santa Fe enacted an $8.50 minimum that applies to all businesses requiring a license or registration from the city, and San Francisco voters similarly approved a citywide minimum wage of $8.50.

City minimum wages are in some sense a hybrid of minimum wages and living wages, more like minimum wages in that they entail broad coverage, yet paralleling living wages by restricting coverage to employers in a city. This has two consequences for thinking about their likely effects. First, just as with standard minimum wages and living wages, city minimum wages likely create both winners—workers who get higher wages and keep their jobs—and losers—workers who lose their jobs or have difficulty finding new ones. And, similarly, a key question is how the gains and losses among low-wage workers are distributed. In particular, are they distributed in such a way that city minimum wages help low-income *families*? Second, given that city minimum wages are neither exactly like the minimum wages nor the living wages that have been studied in the past, we cannot confidently assess their likely effects.

Nonetheless, to shed some light on the likely effects of San Francisco's minimum wage, I examined Census data for 2000 for the city. Although pertaining to a period a few years prior to when the minimum wage will take effect (in early 2004), the Census data are advantageous for two reasons. First, they identify both place of residence and place of work, so that we can examine workers employed in San Francisco.[13] And second, they also provide information on family income. Calculations with these data, reported in Table 5, indicate that a non-trivial number of workers earn the minimum, even in a high-wage city like San Francisco. In particular, using the Census data and inflating wages to 2003, the data indicate 6.2 percent of workers earning a wage equal to or below the state minimum wage of $6.75 and another 4.7 percent earning between $6.75 and $8.50. Thus, as many as 10.9 percent of workers in San Francisco could potentially see their wages rise as a result of the city's minimum wage.[14]

Turning to the distributional question, the table next shows that the lower-wage workers who would be affected by the law are disproportionately young; workers ages 16-24 make up about one-quarter of those earning $8.50 or below, versus only about 9 percent of those earning more than $8.50. Similarly, heads of households are underrepresented among low-wage

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[12] Santa Monica's law extended a general minimum wage to businesses above a certain size in the city's "coastal zone."

[13] In contrast, with Current Population Survey (CPS) data we can only classify people by where they live.

[14] Alternative studies come up with different estimates. Based on a survey of San Francisco employers, Reich and Laitinen (2003) estimate that 5.6 percent of workers in the city earn less than $9, while an alternative study of workers comes up with an estimate of 9.9 percent (CHIS, 2001). In addition, one important issue is the treatment of tipped employees, whose hourly wages may be below the new minimum but whose earnings with tips may be considerably higher. The Census data are not well suited to studying the incomes of tipped workers.

workers. Finally, the last numbers in the table show that although low-wage workers are more likely to come from lower-income families, quite a few come from higher-income families; in particular, about one-third come from families earning $50,000 or more. Although this evidence of course provides no decisive answer regarding the distributional effects of a city minimum wage like San Francisco's, it does highlight the same issue raised earlier—that many beneficiaries of minimum wages may be in higher-income families, rather than poor heads of households.

Given the evidence from state minimum wages and city living wages, what would we expect to be the effects of a city minimum wage? On one hand, a minimum wage imposed on a city would be expected to have more adverse effects than one imposed at the national or state level. Although it is difficult for an employer to choose to locate in another country or state in response to a higher federal or state minimum wage, it is much easier to choose to locate in a neighboring town in response to a local minimum wage.[15] No one is suggesting that large employers will relocate out of San Francisco in response to a higher minimum wage. Rather, these employers may simply find ways to economize on the use of low-wage labor. But small employers with less flexibility may relocate and, perhaps more important, new firms may choose to open elsewhere. Consequently, a higher minimum wage in San Francisco might be expected to impose more costs, and deliver fewer benefits, than the federal and state minimum wage increases that have failed to help poor and low-income families.

On the other hand, because of the lack of experience with city minimum wages, there is no direct evidence on which to draw. The argument could be made that living wage laws, because they apply to narrow geographic areas (although with different kinds of coverage) provide the best available evidence—and evidence that indicates positive distributional effects.

There is, quite simply, no basis for making firm predictions about the effects of city minimum wage laws. The evidence from living wages holds out some hope that distributional effects at the city level are more advantageous for the poor. But the standard minimum wage results point in the opposite direction, and the costs imposed by a city minimum could be more severe. From a research perspective, there is an obvious need for empirical analysis of the actual effects of city minimum wages. From a policy perspective, it is important to emphasize that neither advocates nor opponents as yet have a firm basis for predicting the distributional effects of city minimum wages, although predictions of job loss—which is common to both minimum wages and living wages—are on firmer ground.

[15] My favorite example of how firm location decisions respond to economic incentives comes from my home town, which bordered a college town with blue laws prohibiting liquor stores. Did this deter the establishment of liquor stores? Of course not. It simply affected their location, as liquor stores sat on nearly every major intersection just across the border of the teetotaling town.

Conclusion

Where do all of these estimates leave us regarding the use of mandated wage floors to help poor or low-income families in the United States? I suppose the most apt stance to take based on the evidence is "skeptical." Minimum wages deliver no net benefits to poor or low-income families and, if anything, make them worse off. Living wages have a more salutary effect, reducing urban poverty. But although there is, therefore, a more compelling case for living wages, this evidence does not imply they are the most effective means of reducing poverty. Furthermore, the adverse employment effects of living wages on low-skill individuals suggest that living wages may reduce poverty without necessarily helping the lowest-wage workers, a conclusion reinforced by new evidence in Adams and Neumark (forthcoming).

It may simply be an uncomfortable fact that trying to help low-income families through mandating higher wage floors tends to have negative consequences for the least-skilled workers, since such wage floors amount to a tax on the employment of these workers. In this case, even if wage floors deliver some benefits to low-income families—as appears to be the case for living wages, but not minimum wages—additional policies may be needed to help the most disadvantaged workers and families. These could take the form of a sufficient safety net to protect families with inadequate incomes, strategies to enhance skills that would make individuals in poor families more employable and employable at higher wages, and policies such as earned income tax credits that encourage employment by supplementing income.

A sufficient safety net is easy to defend, in particular in the case of children who suffer consequences of low parental income, yet obviously have in no way chosen to live a life supported by government assistance. Unfortunately, in the United States at least, political support for a sufficient safety net for families with nonworking adults is weak. Enhancing skills is a no-brainer in principle, but difficult and expensive to do in practice (Heckman, 1993). Based on the broader research record (see also Hoffman and Seidman, 2003; Neumark and Wascher, 2001b), although there is reason to be skeptical regarding mandated wage floors, there is more evidence pointing to beneficial distributional effects of earned income tax credits, which by subsidizing employment are very much the opposite of a tax on the use of low-skill labor, and which effectively target low-income families rather than low-wage workers.

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Table 1: Minimum Wages Target Low-Income Families Ineffectively.

Family income-to-needs	% of all workers	% of minimum wage workers
< 1 (poor)	6.1	22.0
1 to 1.25	2.8	6.1
1.25 to 1.5	3.3	6.9
< 1.5 (poor or near-poor)	12.2	35.0
1.5 to 2	8.2	11.9
2 to 3	17.9	20.3
> 3	61.7	32.8

Source: Burkhauser et al. (1996), Table 2.
Note: Calculations based on 1990 March CPS file covering family income in 1989, and 1990 federal minimum wage increase.

Table 2: Minimum Wage Increases Result in More Poor and Near-Poor Families.

	Effect of minimum wage increase on percentage of families in income-to-needs category:		
	Income-to-needs = 0 to 1 (poor)	Income-to-needs = 0 to 1.5	Income-to-needs = 1.5 to 3
Raw data	4.5**	4.1**	-3.4**
Unemployment controls	4.2**	3.5**	-3.2**
Fixed state and year effects	3.8*	3.3**	-4.1**

Source: Neumark et al. (2002), Table 3.
Notes: The data set covers 1986-1995. Reported estimates are percent change in proportion of families in cell. '**' ('*') superscript indicates estimate is statistically significant at 5 percent (10 percent) level. Fixed state and year effects are based on removing common state and year proportional shifts from income-to-needs distribution prior to estimation.

Table 3: Living Wage Laws Raise Wages and Reduce Urban Poverty, but Lower Employment Among the Least-Skilled; Contractor-Only Living Wage Laws Have No Effect.

	Effects of living wage laws on:			
	Wages, lowest decile of wage distribution	Employment probability, lowest decile of predicted wage distribution	Probability that family earnings below poverty	Probability that family income below poverty
All living wage laws	.070**	-.056**	-.048**	-.033**
Contractor-only living wage laws	.005	-.053	…	.026
Business assistance living wage laws	.105**	-.059*	…	-.054**

Sources: Neumark and Adams (2003a and 2003b), various tables.
Notes: All effects shown are for 12-month lags of the living wage, to allow the impact of living wage laws to take effect. Living wages and wages are in logs, so the first column measures wage elasticities, and the remaining columns measure the effect of 100 percent increases in the living wage. The data for the first two columns cover 1996-2000, and for the latter two columns cover 1995-1999. The control group is other urban workers; the regressions include controls for city, year, month, minimum wages, and other individual-level controls in the wage and employment specifications. Each entry is an estimate from a separate specification. '**' ('*') superscript indicates estimate is statistically significant at 5 percent (10 percent) level.

Table 4: Contractor-Only Living Wage Laws Raise Wages Only of Unionized Municipal Workers Who Compete with Contractors.

	Workers:			
	Unionized, municipal	Unionized, non-municipal	Non-unionized, municipal	Non-unionized, non-municipal
Living wage effect	.164**	-.037	-.022	.005

Source: Neumark (2001).
Notes: See notes to Table 3. Table shows effects over a 12-month period, to allow the impact of living wage laws to take effect. Data are aggregated to city-by-quarter level. Table reports wage elasticities. '**' ('*') superscript indicates estimate is statistically significant at 5 percent (10 percent) level. Estimates are weighted by the number of observations in the cell used to construct the wage measure. Teachers, police, and firefighters are excluded from the first column.

Table 5: Many Workers Are Potentially Affected by San Francisco Minimum Wage Law; Many Affected Workers Are Young, Do Not Head Households, and Are in Higher-Income Families.

	Hourly wage:		
	$6.75 or below	$6.75 - $8.50	More than $8.50
% of hourly wage earners	6.2	4.7	89.1
Mean age	36.4	35.3	39.5
% age 16-24	27.6	25.4	8.8
% household head	34.1	30.1	55.0
Mean family income in 1999	$42,388	$47,437	$71,285
% family income < $25,000	48.0	41.2	39.2
% family income ≥ $50,000	31.2	36.8	51.4

Source: Author's calculations using 2000 Census 1% PUMS, based on inflating 1999 earnings to 2003 levels.
Notes: All wage and salary workers who list their place of work as San Francisco are included. Wages were constructed by dividing 1999 wage/salary income by the total number of hours worked in 1999.

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