

**An Empirical Analysis of the Proposed
Los Angeles Living Wage Ordinance**

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Preface and Acknowledgements

This report was commissioned by vote of the Los Angeles City Council on November 15, 1996. Planning for the study had begun some two weeks before. It would not have been possible to conduct a respectable analysis under these time constraints without the generous cooperation of many people on all sides of the “Living Wage” issue. We would like to thank Councilmember Jackie Goldberg and her chief of staff, Sharon Delugach, for meeting with us to discuss the background and goals of the ordinance; Mario Mendoza, of the City Administrative Office, who conducted a substantial preliminary survey of city service contractors, made all of his data available to us, and facilitated our own survey; Assistant Deputy Mayor Steve Rubin, who helped us interpret the survey data and provided helpful feedback on drafts; Fred Merkin, of the City Attorney’s office, who provided us with written and oral feedback on the legal interpretation of the proposed ordinance; Laura Sainz, of the Mayor’s Office of Economic Development, who assisted us in developing information on economic subsidy recipients; June Gibson, of the City Administrative Office, for making as painless as possible the execution and modification of the study contract; and dozens of department heads and other city officials and who took time to help gather data on firms doing business with the City. Several hundred business operators who do work with the City took the time to answer our questions and fill out our survey forms; we are grateful for their help. Finally, we thank the many individuals who gave us input on our drafts or research ideas, including Jeff Grogger, Larry Kimbell, Burton Weisbrod, Robert Pollin, David Fairris, Gary Dymski, Madeline Janis-Aparicio, Carol Zabin, and Richard Carlson.

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Summary and Recommendations

The proposed Living Wage Ordinance (hereinafter “the Ordinance”) would require about twelve hundred firms that lease from, or provide services for the City of Los Angeles to pay their workers (if engaged in the City-funded or City-based work) a “living wage” (\$7.50 an hour, or enough to raise a family of three above the poverty line), provide health benefits, and provide compensated time off for illness, holidays, and vacations. The goals of the Ordinance, as described by its Council sponsors, are threefold: (a) to set, by example, a standard of what the City considers to be fair and appropriate terms of employment; (b) to improve the quality of City services provided by private businesses; and c) to reduce poverty and improve the living conditions of the affected workers.

The City Council commissioned this study of the Ordinance. Broadly speaking, the study had four purposes: (a) to estimate the direct scope, cost and coverage of the Ordinance as proposed; (b) to evaluate the likely success of the Ordinance in achieving its goals; © to assess the indirect economic effects of the Ordinance; and (d) to make recommendations, including alternate ways of approaching the Ordinance’s goals while minimizing costs and adverse side-effects. The study has provided some fairly clear answers to each of these questions, and identifies important ambiguities that remain. Our key findings are summarized below.

Scope, Cost, and Coverage of the Ordinance: City Service Contracts

The Ordinance, in its current version (City Attorney’s November 27th edition, reflecting changes through November 13th), covers three groups of employers: firms contracting with the City to provide services; some firms that conduct business on City property (e.g., LAX concessionaires); and firms that receive substantial economic development incentives from the City. Over these three categories, we have the most complete information about the first, and less about the last; there is also more ambiguity about the scope of coverage in the second and third categories. Section 2 of the main text, and Appendix A, describe the methods behind each of the following estimates. Note that with each of these estimates, we describe current businesses as being “covered” by the Ordinance, although only future contractors would in fact be covered.

--The City currently has roughly 1,000 service contracts that exceed the \$25,000 threshold at a total annual cost of roughly \$350 million. Only about 350 of these contracts, worth \$100 million, actually involve workers earning less than \$7.50 per hour. If the Ordinance applied to all of these firms:

- 2,500 workers would get an average wage increase of \$1.25 an hour to \$7.50;
- 1,800 workers would receive health benefits;

- At least 3,500 workers would receive more paid days off for sick leave, vacation, and holidays;
- The total cost of these changes would be around \$16-24 million, depending on how the Ordinance's health insurance mandate is interpreted. Only a little over \$5 million of this total would go into actual wage increases.
- The principal uncertainty in our estimate of costs to service contractors concerns the reach of the "time off" provisions. In the Ordinance's current form, these requirements extend to all employees of the covered firm who work on City-funded activities, regardless of their rate of pay. Our data only covered hourly employees; this provision could have significant coverage effects in firms that have mostly salaried employees or employees making more than \$10 per hour.
- These estimates do not include any figures for subcontractors. Out of two hundred sixty firms contacted on this issue, only eleven of the firms reported subcontractors engaged in City-related work. Inclusion of subcontractors would increase our estimates of coverage, but not significantly.

--The total cost of the Ordinance to service contractors thus represents about 4-7% of the total amount of all City service contracts, although most of the cost is concentrated among a relatively small number of contractors. These costs could be covered in one of three ways:

- The City could decide to absorb the cost, and find higher revenues or offsetting spending reductions to pay for it. If the City did absorb the cost, the increase in City expenses would take several years to be fully felt, since many of the contracts are for several years and only new contracts are covered.
- The City could make case-by-case judgments about the ability of contractors to absorb the cost, increasing contract amounts where it concluded that the firm could not absorb the cost. We have seen no evidence on the question of whether City service contractors have, in some cases, above-average profit margins that would make it possible for them to absorb the higher costs. Even if such profits existed, however, the City will have difficulty making contractors absorb costs in the absence of changes in methods of awarding contracts.
- The City could allow the coverage of the new expense to be worked out by individual contracting departments. We predict that under this policy, the cost will eventually be borne by the City in the form of

higher contracting costs (when departments are able to secure higher appropriations) or lower services.

Scope, Cost, and Coverage: City-Authorized Concessions

--Over a thousand businesses operate on City property with leases and permits. The Ordinance covers some but not all of these; the exact line of coverage is unclear. We defined the coverage to include businesses that provide services (mostly public services) that the City could and would probably provide if the lessee or permit-holder did not. We studied three City operations that would include most of the possible coverage: LAX, LA Harbor, and the City's parks and outdoor recreational facilities. We did not study the Convention Center or the Sports Arena. In the three major operations we studied, about 250 businesses were potentially covered by the Ordinance; most of whom did have workers earning less than \$7.50 per hour. If the Ordinance applied to all of these firms:

- 2,300 workers (about 1,900 FTEs) would get an average wage increase of \$1.38 an hour to \$7.50;
- 670 additional workers would receive health benefits;
- 3,200 workers would receive additional time off;
- The total cost of these changes would be between \$12 and \$18 million, depending on how the Ordinance's health insurance mandate is interpreted. Only about \$5.5 million of this total would go into actual wage increases.
- The major uncertainties in these estimates stems from the "time-off" provision (see the previous section) and the lack of information on two major City operations.

--Because the concessions generally support themselves by selling goods and services to the public, and not through City payments, the allocation of the higher labor costs is more complex. The City would probably bear some of the cost through lower lease payments.

Scope, Cost, and Coverage: Financial Assistance Recipients

--We found no hard evidence that any of the current recipients of financial assistance from the City will be affected by the Ordinance. The Ordinance covers firms receiving assistance from the City (for economic or jobs development) if the net subsidy in the assistance is over \$100,000 annually or over \$1 million at any one time. We surveyed a number of the City's assistance programs, and none of those surveyed met the threshold provided for in the Ordinance. This implies that the Ordinance's impact here will be small;

but if any firm does pass this threshold, the size of the subsidy will be large enough so that each covered firm might have a sizeable effect on the total impact.

Overall Reach of the Ordinance

Across the three areas of coverage, the Ordinance would provide pay increases to nearly five thousand workers (about 4,000 full-time-equivalent employees, or FTEs) and would provide added benefits to about seven thousand workers (including those receiving pay raises). The total increase in labor costs would be between \$28 and \$42 million. The City would eventually pay for most of that increase through higher costs or lower services.

Success of the Ordinance in Meeting Its Goals

--*Setting a standard, by example, of what the City considers fair and appropriate terms of employment.* The Ordinance is very effective in meeting this goal. By creating widely-applied, uniform standards to the covered contractors and concessionaires, the Ordinance sends a clear message about the City's labor goals.

--*Improving the quality of City services.* When the City contracts out for services, it is difficult to compare bidders on grounds other than price. Bidders may thus have an undue incentive to minimize on labor costs and provide lower quality services so that they have the lowest bid. Bidders that plan to use more or better quality labor may thus be frozen out of the competitive process. These situations are hard to correct if the City has poor information about service quality. Setting a minimum wage for service contract workers is thus a plausible strategy for setting service standards.

It is very likely that the Ordinance would improve quality-adjusted worker productivity in two ways:

- Higher wages and benefits reduce worker turnover. This increases the average level of experience among workers, and therefore should improve the quality of services provided.
- Higher wages and benefits enable employers to recruit workers with stronger skills to the jobs affected by the Ordinance.

However, a more narrowly-tailored Ordinance could probably capture many of these benefits at lower cost. There are probably areas where performance is easy to observe (e.g., landscaping) or where particular types of work are done well by low-wage workers. It is also difficult to know whether the City is getting its money's worth -- exactly because productivity gains in many areas are hard to observe. A more narrowly-tailored Ordinance, by focusing on fewer areas, might make it feasible for overseers to assess improvements in quality.

--*Reduce poverty and improve the living conditions of affected workers.* It has been well-established by labor economists that raising the minimum wage is a very blunt instrument for fighting poverty, since low-wage workers are not always from low-income families. In Los Angeles, we estimated that about 20% of service workers earning less than \$7.50 per hour are from families below the poverty line (i.e., \$16,000 for a family of four), and another 20% are in “near-poor” families (those with incomes between 100% and 150% of the poverty line, or \$16 - 24,000 for a family of four). At the other extreme, 33% of the low-wage workers in Los Angeles live in families with incomes over \$45,000 per year. Of the four thousand workers receiving pay raises under the Ordinance, we estimate that about eight hundred would be lifted above the poverty line. Some of the indirect economic effects of the Ordinance could partially offset this achievement (see below).

--Other analysts of this Ordinance, or of similar proposals, have concluded that most of the higher labor costs the Ordinance mandates would be “lost” to the state and federal governments, as workers paid higher taxes and received fewer welfare benefits. Our analysis suggests that these conclusions are overstated. Since most of the covered workers are not poor, and even those who are have less than complete participation rates in many benefit programs, we estimate that only about 5% of the higher labor costs will be offset by lower worker benefits. Moreover, since most of the Ordinance’s labor costs are in the form of benefits, rather than wages, only about 15% of the higher labor costs will be offset by higher worker taxes. Thus, most of the mandated wage and benefit increases will translate into better living standards for the recipients.

Indirect Economic Effects of the Ordinance

It is difficult for an individual City operating in a regional and national economy -- even for a City as large as Los Angeles -- to unilaterally influence wage and labor standards. An individual city cannot capture many of the benefits (e.g., lower welfare) or control many of the side effects (e.g., secondary labor market effects) that flow from a geographically and administratively limited standard. These constraints, along with some intrinsic consequences of a substantial mandated wage increase, contribute to several indirect economic effects:

--The Ordinance would produce some loss of jobs. Contractors and concessionaires facing higher costs will try to raise prices (higher contract amounts, lower lease payments and higher concession prices) and cut costs (by reducing the number of workers). How much this happens will depend on a number of factors discussed in the main text. Most crucially, it depends on the willingness of the City to absorb the higher labor costs mandated by the Ordinance. If the City responds to an increase in costs in the way cities studied in the economic literature typically do, the Ordinance would produce an overall loss of about three hundred and fifty jobs. If the City allows cost pass-throughs or improves the contracting process, the job loss among low-wage workers will be significantly less.

--The size of the job loss resulting from the Ordinance will determine the size of the “secondary market effects” in non-covered markets. Workers displaced by the Ordinance will seek jobs in the 99% of the Los Angeles labor market that is unaffected by the

Ordinance's provisions. Since these workers generally have a strong need or desire for jobs, they will often accept lower wages in the uncovered market. Microeconomic theory predicts, as a consequence, a slight decline in wages in the secondary market. In effect, displacement of workers sets in motion a sort of domino process, in which the displaced workers will displace other workers by accepting lower wages, and these workers will repeat the phenomenon. This process ends of absorbing back into the labor force most of the workers displaced from city contract work, but the process could also lower enough workers' wages to offset, from an aggregate point of view, a significant part of the higher payments going to low-wage workers under the Ordinance. However, the empirical literature on these secondary market effects is too weak to permit us to reliably estimate its size.

Nonetheless, these secondary market effects give us an important added reason to be concerned about how many workers are displaced by the Ordinance. That number, in turn, depends on how the City responds to increases in contractor costs.

--The Ordinance could foster unionization of low-wage workers in other sectors, or stimulate the adoption of higher wage and benefit standards by other employers. Results like this have often followed the introduction of a "covered market" in the form of union entry into a new industry or regional economy. We know of no analyzed precedent for this type of effect from the creation of a small, high-wage "covered" market by a City.

--As we noted earlier, about 20% of the increased labor costs mandated by the Ordinance is "lost" from the regional economy, due to declines in the receipt of welfare and other benefits and increases in taxes. This has beneficial social effects, but it contributes to a slight net loss in aggregate income for the regional economy as a whole. If, however, corporate profits are lowered, this loss in aggregate income will be offset to some degree by a decline in corporate taxes. The Ordinance will produce an "inflow" of income if some of the costs are borne by businesses whose owners live outside the Los Angeles area (and thus "remove" lower profits from the region). The net "inflow" is almost certainly smaller than the net outflow, so the total direct effect of the Ordinance on the Los Angeles economy is slightly negative -- though small relative to the scope of the Ordinance and very, very small relative to the overall economy.

--Some of the City's economic development activities (especially those in "enterprise zones") aim to reduce long-term unemployment by creating new, entry-level jobs. If these activities carried a higher mandated wage and benefits, fewer of these new jobs will be created. As a practical matter, the current coverage thresholds in the Ordinance appear to exempt all current economic assistance recipients. However, the potential is there for a direct conflict between the mechanisms of the Ordinance and the goal and operation of some of these economic assistance programs.

--Within the Los Angeles economy, the Ordinance will produce some income redistribution from areas where taxes are paid and business owners live to areas where covered workers live. Our empirical research suggests that the locational differences between these populations are not very great, so the redistribution would be very modest.

Recommendations

In the debate over the Living Wage concept, an important option that has been overlooked is the federal Earned Income Tax Credit (EITC). The EITC was begun in the late 1970s and was greatly expanded by the Clinton Administration in 1993. The EITC works as a sort of “negative income tax” for low-income families with job earnings. A worker who is the sole support for her family, has two children and worked full-time in 1996 at an hourly wage of \$5.75 (the statewide minimum wage that will be in effect in a year) would be eligible for an EITC of roughly \$3,500 -- enough, in other words, to make her effective wage \$7.50 per hour. There is thus a mechanism already in place to achieve one of the Ordinance’s central goals.

The problem is that a majority of the Los Angeles residents who are eligible for the EITC do not know about it or do not use it. Even those who use it tend to receive the EITC in a lump sum when they file a tax return, even though the program now makes it relatively easy for employers to pass the benefit on to workers in the form of regular “wage subsidy” payments. We estimate that the total value of unused EITC benefits in the City is \$100 million per year.

From the City’s standpoint, the enormous advantage of an EITC over a Living Wage is that the EITC brings more outside funds into the metropolitan area, while a Living Wage tends to reduce the inflow of outside benefits and increases the outflow of taxes. Moreover, from a policy standpoint, the EITC is perfectly targeted at the neediest population: all of its benefits go to low-income families, and none of the EITC income is taken into account in determining the recipient’s eligibility for other means-tested benefits.

If the City takes steps to increase the use of the EITC by City service contractors, it can help achieve some of the other goals of the Ordinance. For example, if City contractors offer year-round wage supplements from the EITC to their qualified low-wage workers, they will presumably secure lower turnover from their workers and some of the other productivity benefits that the Ordinance seeks to achieve.

The EITC cannot achieve all of the goals of the Ordinance, such as the provision of health insurance to contract workers, or the establishment of “model employer” criteria. Moreover, many of the weaknesses of the Ordinance can be greatly mitigated by carefully targeting its provisions. There is good reason to think that a scaled-down version of the Ordinance would cost-effectively meet many of its goals. The more targeted Ordinance would also be easier to administer and to evaluate.

We therefore conclude that the following steps would be an effective strategy for advancing the goals of the Living Wage Ordinance:

- 1) Implement a targeted Living Wage Ordinance. The Ordinance would cover approximately 100 City service contracts and concessions, in areas selected on the basis of these criteria: (a) a concentration of low-wage workers in the contracts; (b) covered work in

which poor performance is a documented or suspected concern; (c) work in which the low-wage workers tend to belong predominantly to low-income families. These 100 contracts would reach about 75% of the workers who would be covered by the service contracts provisions currently in the Ordinance. The office administering the Ordinance should monitor these contracts carefully, to investigate the competitiveness of the bidding process, and the changes in employer bidding and employment practices that result from implementation of the Ordinance. Where the administering office is persuaded that the higher labor costs will lead to more than a 5% loss in jobs under the contract, the office should provide recommendations on cost pass-throughs to appropriate City officials.

2) The wage and benefit package mandated by the Ordinance should be modified to provide the following:

- A minimum wage of \$7.25 per hour;
- Health benefits that are either (a) comparable to those being provided to City workers engaged in similar work, or (b) involve an average employer cost of \$2,000 per covered employee. The employer should bear the entire cost of the policy, though policy co-payments and modest deductibles should be permitted. The \$2,000 figure reflects the average amount per worker spent on health insurance by service contractors who currently provide health benefits to their workers. Employers not providing these health benefits would be required to pay workers at least \$8.50 per hour.
- The provisions for holidays, sick days and vacation days should be modified to permit workers a total of twelve days off annually, which can be used in any of these three categories at the worker's discretion. These provisions should also only apply to workers making less than \$8.50 per hour.

3) We estimate that the total cost of this trial program to the City would be \$3-5 million annually, including administrative and evaluation costs. The exact amount would depend on the degree of cost pass-throughs. This amount would be lower during the first few years, until all of the covered contracts came up for renewal and coverage.

4) This targeted Living Wage Ordinance should be subjected to a clearly specified evaluation mechanism which will provide clear answers on the following issues: (a) is the Ordinance being enforced; (b) how many workers are displaced; (c) are there productivity gains in the covered contracts; and (d) what is the added cost to the City? The City should set targets on each of these criteria, annually review the Ordinance's success in achieving these criteria, and discontinue the mandate if the program does not measure up.

5) The City should adopt legislation requiring parties that engage in City business to take the following steps to encourage use of the EITC among their low-wage workers:

- Inform all workers making less than \$12 per hour of their potential eligibility for the EITC;
- Make available to workers the necessary forms to secure year-round EITC wage supplements from the employer.
- Parties certifying that less than 5% of their workers engaged on City work make less than \$7.50 per hour would be exempt from the above requirements in (2).

6) The City should implement a program aimed at increasing participation in the EITC. The program would have four components:

- Oversee compliance by employers doing business with the City with the provisions of (5), above;
- Conduct outreach in communities with a concentration of low-wage, low-income workers to increase familiarity with and participation in the EITC program;
- Conduct a media-based information project on EITC, to disseminate information on eligibility and usage to the general Los Angeles community;
- Maintain a technical assistance office to help workers and employers use the EITC effectively.

7) The total cost of this program would be \$1 million annually. But if the program is successful in increasing citywide participation rates in the EITC from 48% to 60%, the program will generate roughly \$50 million for the local economy, including some \$2 million in additional tax revenues for the City.

8) At least some parts of this program should be temporary. If the program is successful, knowledge and usage of the EITC by employers and workers will increase, making the program less necessary. If the program is unsuccessful, of course, the argument for making it “temporary” is even stronger. The City should therefore evaluate, by a variety of statistical means, the annual change in EITC usage among eligible parties in Los Angeles. The program should be subject to annual review and should be reduced or eliminated when the demonstrable annual increase in EITC usage in Los Angeles falls below \$5 million.

An Empirical Analysis of the Proposed Los Angeles Living Wage Ordinance

Section One. Introduction

The authors of this report, along with a staff of ten research associates, have spent the past six weeks on an intensive analysis of the Proposed Living Wage Ordinance (“the Ordinance”). Our charge from the City of Los Angeles was to determine, as effectively as we could within the short time frame, the likely and significant consequences of enacting the Ordinance. The preceding Summary distills our principal findings; this main report explains our methods, research, reasoning, and presents more detailed findings.

The dramatic erosion of the federal minimum wage over the past fifteen years, the increase in income inequality in the United States over the same period, and the widely-noted failure of wages to rise substantially during the present economic growth cycle, have all generated wide interest in minimum wage legislation. In August, the United States Congress enacted the first increase in the minimum wage since 1991, raising it from \$4.25 to \$4.75 as of October 1, 1996, and to \$5.15 as of September 1, 1997.¹ In November, California voters passed Proposition 210, which will raise the minimum wage in California to \$5.75 by March 1, 1998.² Over the past two years, legislators in some two dozen local jurisdictions across the country have introduced “Living Wage” bills, which generally seek to set a floor on the wages paid on publicly-funded contracts.³ In 1995, Baltimore and Milwaukee both adopted, proposals setting wage floors for workers on city contracts. A larger number of cities and states have linked wage floors to economic subsidy programs of various sorts.

The Ordinance examined in this study is a classic embodiment of the “Living Wage” approach and philosophy. If passed, it would require a wide group of employers that do business with the City of Los Angeles (“the City”) to pay workers engaged in that business a wage of at least \$7.50 an hour and to provide them with health insurance, paid holidays, up to twelve paid sick days per year, and seven days annual vacation. The health insurance requirement would be waived for employees earning at least \$9.50 per hour. Under the latest (November 13th) draft of the Ordinance, as interpreted by the City Attorney, the Ordinance would extend to the following workers:

¹ Paul Richter and James Gerstenzang, “Clinton Signs Minimum Wage Hike,” *Los Angeles Times*, 21 Aug. 1996, Part A, p. 1.

² “Elections ‘96; Other State Measures,” *Los Angeles Times*, 7 Nov. 1996, Part A, p. 1.

³ Los Angeles Living Wage Coalition, “National Living Wage Campaigns: A Look at Corporate Accountability and Living Wage Legislation Across the Nation” (June, 1996).

--Those who do work on city service contracts of \$25,000 or more, including those who perform only incidental work on the contracts and those who work for subcontractors.

--Those who are employed by lessees or licensees of the City that provide services on City property, if the service is one intrinsic to the accomplishment of the City's goals at that site and the service would probably be provided by the City if it was not provided by a lessee or licensee.⁴

--Those who are working more than half-time on a project funded or subsidized by economic development programs operated by the City, if the subsidy is either a one-time grant of \$1 million or more or an ongoing subsidy that amounts to over \$100,000 on an annualized basis.

With the emergence of "Living Wage" proposals around the country, studies have begun to appear assessing its consequences and costs. Although no research has yet appeared in academic journals, four unpublished analyses have come out: (1) a study by an economic consulting firm in Chicago (the "Chicago" study), which, on commission by the City of Chicago, produced a highly critical evaluation of a "Living Wage" proposal there that was quite similar to the Los Angeles proposal;⁵ (2) a study by a team of economists at the University of California at Riverside (the "Riverside" study), which analyzed an earlier version of the Ordinance considered in this study, was funded by mostly private sources, and produced a report strongly supportive of the Ordinance;⁶ (3) a highly critical review of the Riverside study written by Richard Carlson of Spectrum Economics, and commissioned by the Los Angeles Chamber of Commerce;⁷ and (4) a narrower study by a public policy institute in Washington, D.C., which was coauthored by one of the Riverside coauthors and which examined the first year effects of the Baltimore Living Wage Ordinance and found no negative side-effects from its operation (the "Baltimore" study).⁸

⁴ The Ordinance itself is quite ambiguous about which lessees and permit-holders might be covered. Sec. 10.37.1(h) provides "A City tenant or concessionaire shall be deemed to be rendering services for the City for purposes of this article if included in a regulation to such effect promulgated under the authority of section 10.37.5." Our interpretation is based on discussions with the sponsors and the City Attorney's office.

Even in the terms we have suggested, the distinction between what is covered and what is not covered is often ambiguous. Two examples offered by the City Attorney's office are these: at LAX, a food concession operated in a terminal would be covered, while a car rental operation would not. At a municipal golf course, a licensed golf "pro" giving lesson would be covered but a pro shop would not.

⁵ George Tolley, Peter Bernstein, and Michael Lesage, *Economic Analysis of Living Wage Ordinance* (RCF Economic and Financial Consulting, Inc.), 24 Jun. 1996.

⁶ Robert Pollin, proj. dir., *Economic Analysis of the Los Angeles Living Wage Ordinance*, Oct. 1996.

⁷ Richard C. Carlson, *Economic Impacts of the Proposed Living Wage Ordinance for the City of Los Angeles*, Final Report (Spectrum Economics, Inc.), 9 Dec. 1996.

⁸ Mark Weisbrot and Michelle Sforza-Roderick, *Baltimore's Living Wage Law* (The Preamble Center for Public Policy, Wash., D.C.), Oct. 1996.

We have studied these reports carefully and learned much from them. Each undertook some imaginative analyses and produced some intriguing results. Together these studies, which drew sharply opposing conclusions on most of the issues they collectively took up, have set in clear relief a number of key issues that we explore here. The Riverside study also made a very significant effort to compile data on the range of possibly affected City contracts, and this provided a good benchmark against which to measure our own efforts (we compare our results in detail in Section 2). We wish to acknowledge that, as in all research efforts, investigators benefit greatly from a careful consideration of earlier work.

Our study is different from these predecessors in three respects. First, we had the benefit of direct access to City officials and to the data collected by the City. We could approach current contractors and lessees of the City as “official” representatives, and received much helpful cooperation as a result. Second, we were not writing an “advocacy” piece in the sense that the other studies were (though their authors might disagree with this characterization). We began the study without definite views on the merits of the proposed Ordinance, and we saw -- and continue to see -- many of the questions raised by the proposal as close ones, with complex answers. Third, we did not see our mission as consisting only of delivering a “verdict” on the proposal, but on identifying ways that the Ordinance could be improved to better attain its goals.

Our study does share with its predecessors an important limitation: time. We began planning this study two months ago and began executing it six weeks ago. A longer study could have collected much richer and more complete data on the issues we examine, might have looked closely at the experiences of cities that have adopted similar laws, and probably would have answered some of the questions that we leave open here. More time would also have smoothed some of the rough edges in what we have done. But even this brief analysis has generated quite a bit of information and knowledge about the workings and dynamic effects of the Ordinance, and suggests clear ways in which it can be strengthened. We doubt that a longer study would substantially change any of our recommendations.

Section Two: The Coverage and Direct Impact of the Ordinance

The most difficult question our study faced -- and perhaps the most important one, since estimates of indirect effects in the other sections of our report flow from our conclusions here -- concerns the practical scope of the Ordinance: how many businesses and workers would its provisions directly affect? Although a large survey conducted by the Office of the City Administration Officer during the summer and early fall gathered valuable data on a large percentage of the firms most obviously covered by the Ordinance, the survey had very modest goals, seeking to get general information on the contracting firms that would be affected most obviously by the Ordinance. When we began our study, we therefore had worker information on only about 20% of the total population of city service contractors, no information about some major departments (e.g., DWP and the Harbor), and limited data on lessees, permit holders operating on city property, and economic subsidy recipients. We also had no information about administrative support personnel or subcontractors used by city service contractors and possibly covered by the Ordinance.

The largest component of our study was a brief but intense survey effort aimed at filling the gaps in our knowledge about the Ordinance's coverage. Our survey had four components. First, we developed a fairly complete census of all the businesses potentially affected by the Ordinance, including over 1100 service contracts, well over one thousand lessees and permit holders (which we will collectively describe as the "concessionaires"), and dozens of firms receiving economic subsidies from the City. Second, for the service contractors, we supplemented the City's focused survey with a longer survey of a random sample of the entire universe of covered contracts. Our sample, which is described more fully in Appendix A, collected information from over 300 firms. Third, for the concessionaires, we determined that the number of firms that were probably intended to be covered by the Ordinance (see our interpretation in Section 1, above) was about 250. The City had provided us with information on over half of these firms, and we attempted to contact the remainder. For three major sites of concessionaires -- LAX, the Harbor, and the public parks and golf courses -- we secured data from most of those covered, and had enough information on those that we did not reach that we could generalize from our sample. A significant failing of this part of our analysis, however, was the absence of a good census, or any direct data, on two city-owned sites of concessions: the Sports Arena and the Convention Center. Fourth, we contacted officials at all of the principal economic development programs and secured enough data to allow us to determine whether any of the beneficiaries of those programs met the thresholds of coverage specified in the Ordinance.

For each of the covered firms we contacted, we sought information on the number of workers within specified wage ranges who did some work on the City contract or concession, the average wage rates of affected workers, the degree to which these workers received health benefits and the cost of those benefits, and the current allowances these workers received for sick days, holidays, and vacation days. We specifically asked about

administrative support personnel who worked on the contract or concession, and about the employers' use of subcontractors.⁹

Reliability. How accurate is the information collected through the methods we have just described? There are three ways that errors can creep in. First, if our “universe” of firms doing business with the City had significant gaps, all of our other analyses would reflect those gaps. There are undoubtedly some gaps of this sort, since the process of compiling the universe relied on the responsiveness of many different people across different City departments who used a variety of methods to assemble their own lists. However, the close cooperation of the Office of the City Administrative Officer allowed us to collect information from all major departments and virtually all of the smaller departments. Moreover, we were able to compare our lists of service contracts with a similar “census” of contracts conducted last year, and performed other checks to satisfy ourselves that our universe was reasonably complete.¹⁰ Second, our sample of responding firms could be skewed in a variety of ways. To examine this possibility, we have checked our sample against our universe of firms and established that, by a variety of measures, our sample seems to fairly represent the entire population. Third, our procedure could produce mistaken estimates if many responding firms gave us inaccurate information. It seems likely that some respondents overlooked some employees (especially those working only indirectly on a service contract). Some respondents might have been embarrassed to admit, even in a confidential survey, how little they paid some employees; others might have wanted to exaggerate the number of low-wage workers to emphasize how severely their operation would be affected by the Ordinance. We took some comfort from the general consistency of the responses to our survey with those the City had obtained in its own survey (it seemed less likely to us that respondents would misrepresent facts on an official, mandatory survey). In general, however, we had to rely on our sense that the data we were receiving hung together in ways that seemed credible and consistent.

Overall, we feel confident that all of these potential problems did not detract substantially from the accuracy of our estimates.¹¹

Number of Affected Workers. The first three tables in this section (2.1 through 2.3) show our estimates of the number of workers affected by the Ordinance. We have broken this data down by individual department or operation (when that would not jeopardize any

⁹ We gathered this information with a survey instrument that was faxed to firms. We did not include in our final analysis data on subcontractors, because of a lack of available information. However, because only 11 out of 260 firms we spoke to on this issue had subcontractors working on City projects, we do not think that inclusion of subcontractors would significantly affect our estimates.

¹⁰ The two notable exceptions are the Sports Arena and Convention Center as concessionaire sites, as noted above.

¹¹ As we will discuss more fully below, our estimates are in most respects quite consistent with those obtained by the Riverside study through a very different methodology, which provides another helpful check.

respondent's anonymity), to provide as detailed a picture as possible. Overall, we estimate that about 4,800 people working for covered firms currently earn less than \$7.50 per hour. An additional 2,500 covered workers earn more than \$7.50 per hour, but receive no health care benefits -- or benefits that probably fail to meet the Ordinance's requirements -- and would be eligible for some increase in health benefits under the Ordinance. In both of these cases, the number of affected workers is a relatively small proportion of the total number of persons engaged in covered work -- the great majority of the employees on city service contracts, in particular, are receiving wages and/or health benefits above the thresholds set by the Ordinance.

The other benefits mandated by the Ordinance -- the provision of paid holidays, twelve paid sick days, and seven paid vacation days -- could apply to a much larger population. Relatively few of the firms we surveyed provided as many paid days off as the Ordinance mandated, and since there is no "wage limit" governing the reach of this benefit (i.e., all employees are eligible for this benefit regardless of their wage), it is possible that this provision reaches most of the employees who work on City "business" at most of the covered firms -- potentially tens of thousands of workers. Our database did not permit an estimate of how many people that might be. We do know that the number of affected employees is at least ten thousand; but in this one instance, our estimate is intended as a minimum figure rather than a fairly reliable measurement.

Over a third of the low-wage employees covered by the Ordinance work part-time, so we have provided in our tables estimates of "full-time equivalent" (FTE) workers (computed by multiplying the number of workers by their average weekly hours, and then dividing by forty). Both "real" and "FTE" counts have their uses; our FTE estimates are generally about 20% less than our head counts.

As we have noted, the current language of the Ordinance covers persons who work on service contracts regardless of what proportion of their time is spent on the City-related work. This means, in theory, that the Ordinance would cover not only a low-wage security worker stationed at a City facility, but also a low-wage clerk who spends a small fraction of his or her time processing the security worker's paycheck. This language could potentially greatly expand the reach of the Ordinance, but our survey respondents identified relatively few "administrative support" workers who spent time on city contracts. The numbers were lower than expected for three reasons: first, many respondents probably overlooked administrative workers who spent very little time on the City contracts; second, many of the administrative workers earn more than \$7.50 per hour; and third, many of the contracting businesses are small operations in which the owners do their own administrative work.¹² Important exceptions are firms that process data for the city and administrative support personnel for social service agencies, mostly non-profits. Based on the firms reporting in our survey, we estimate that there are between 200 and 250 administrative support workers making less than \$7.50 per hour and spending some time working on City service contracts.

¹² Only fifteen firms in our sample of 375 reported having administrative workers covered by the Ordinance.

We estimate that there are between 500 to 600 administrative support workers who (a) make between \$7.50 and \$9.50, (b) do not have health insurance, and c) spend some time working on City service contracts. We are somewhat skeptical of these numbers, however, because these figures seem particularly vulnerable to underreporting by firms.

To recap, we estimate that about 4,800 workers would receive pay raises under the Ordinance; about 2,500 more would receive health insurance; and at least 10,000 workers (but probably a much larger number) would receive more paid days off.

Table 2.1
Service Contractors
Workers Making Less Than \$7.50 Per Hour

| Type Of Contract | Number of Workers Under \$7.50 | Number of FTE Under \$7.50 | Mean Wage | Percentage With Some Health Benefits | Mean Days Off |
|-------------------------|---------------------------------------|-----------------------------------|------------------|---|----------------------|
| Landscape | 84 | 61 | \$6.48 | 0.40 | 12 |
| Laborer | 31 | 22 | \$6.14 | 0.20 | 3.3 |
| Transit | 37 | 34 | \$6.46 | 0.90 | 13.3 |
| Food Service | 206 | 55 | \$6.84 | 1.0 | unknown |
| Other* | 57 | 47 | \$6.76 | 0.6 | 29.3 |
| Janitorial | 501 | 461 | \$5.87 | 0.6 | 18.3 |
| Security | 526 | 498 | \$6.67 | 0.00 | 0.00 |
| Parking | 249 | 206 | \$5.39 | 0.2 | 7 |
| Social Services | 508 | 305 | \$6.43 | 0.49 | 21 |
| Child Care | 52 | 43 | \$6.40 | 0.50 | 32 |
| Subtotal | 2250 | 1732 | \$6.25 | 0.36 | 11.7 |
| Admin. Support | 227 | 155 | N/A | N/A | N/A |
| Grand Total | 2477 | 1887 | \$6.25 | 0.36 | 11.7 |

*Category unnamed to preserve anonymity

Table 2.2
Service Contractors
Workers Making \$7.50 - \$9.50 Per Hour

| Type of Contract | Number of Affected Workers \$7.50 - \$9.50 | Number of Affected FTE \$7.50 - \$9.50 | Total Workers \$7.50- \$9.50 | Mean Wage | Percent With Health Benefits | Mean Days Off |
|-------------------------|---|---|-------------------------------------|------------------|-------------------------------------|----------------------|
| Landscape | 77 | 39 | 77 | \$8.47 | 0.1 | 12.8 |
| Laborer | 38 | 31 | 51 | \$8.22 | 0.6 | 19.4 |
| Transit | 55 | 50 | 59 | \$8.55 | 0.8 | 23.5 |
| Food Service | 372 | 105 | 372 | \$8.39 | 1.0 | N/A |
| Other* | 65 | 63 | 65 | \$7.50 | 1.0 | 22.6 |
| Janitorial | 6 | 6 | 6 | \$8.28 | 0.3 | 0.00 |
| Security | 59 | 83 | 58 | \$7.99 | 0.00 | 0.00 |
| Parking | 47 | 35 | 47 | \$8.25 | 0.00 | 0.00 |
| Social Services | 450 | 240 | 532 | \$9.00 | 0.47 | 15.25 |
| Child Care | 35 | 35 | 35 | \$8.92 | 1.0 | 32 |
| Subtotal | 1204 | 687 | 1302 | \$8.59 | 0.62 | 10.8 |
| Admin. Support | 568 | 503 | 568 | N/A | N/A | N/A |
| Grand Total | 1772 | 1190 | 1870 | \$8.59 | 0.62 | 10.8 |

* Category unnamed to preserve anonymity

Table 2.3
 Concessionaires
 Workers Making Less Than \$7.50 Per Hour &
 Workers Making Between \$7.50 and \$9.50 Per Hour
 (Expanded Definition of Coverage: See Text for Discussion)

| Type Of Contract | Number of Workers Under \$7.50 | Number of FTE Under \$7.50 | | Mean Wage | Percent With Some Health Benefits | Mean Days Off |
|-------------------------|--|--|-----------------------------|-----------|-----------------------------------|---------------|
| Airport | 1650 | 1532 | | | | |
| Harbor | 306 | 185 | | | | |
| Recreation & Parks | 313 | 208 | | | | |
| Total | 2269 | 1925 | | \$6.12 | 84% | 14.6 |
| | | | | | | |
| | Number of Affected Workers \$7.50 - \$9.50 | Number of Affected FTE \$7.50 - \$9.50 | Total Workers \$7.50-\$9.50 | Mean Wage | Percent With Health Benefits | Mean Days Off |
| Airport | 596 | 586 | 810 | | | |
| Harbor | 47 | 39 | 47 | | | |
| Recreation & Parks | 28 | 26 | 28 | | | |
| Total | 671 | 651 | 885 | \$8.44 | 85% | 16.6 |

Costs. To determine the total cost of the added wages and benefits for the covered workers, it was important to understand what workers currently received. Very few of those affected by the Ordinance currently receive the minimum wage and no benefits. The average worker who made less than \$7.50 per hour earned about \$6.25 per hour, so the cost of increasing compensation to \$7.50 for this group was about \$10.7 million.¹³ Similarly, close to half of the low-wage workers already have some form of health benefit, although usually with significant gaps in coverage and only partial payment by the employer. We calculated the cost of the health provisions by determining what it would cost contractors and lessees to bring their health insurance contribution up to full coverage. Finally, most of the workers -- particularly those working full-time -- already received some paid days off. We calculated the added cost by assuming an additional eight hours at the relevant hourly wage for each additional day that each worker would be entitled to receive.

Because our surveys gave us quite specific data about the number, earnings, and benefits of a large sample of covered workers, most of our cost analysis was straightforward. The main area of ambiguity arose from health care costs under the Ordinance. Since the Ordinance provides that employers can choose between giving their low-wage workers full health insurance or paying them an additional \$2 per hour (\$9.50 instead of \$7.50), one could estimate the cost of health insurance as \$2 * 2,080 hours per year, or roughly \$4,000 per worker per year. However, we found in the course of our survey that when employers provided what they regarded as full health care coverage, the total cost was typically around \$2,000 per worker per year. Because the Ordinance itself is vague about the exact amount of benefits to be provided, we decided to calculate the medical insurance cost using both a \$2,000 per worker assumption and a \$4,000 per worker assumption. Because, as it turns out, the medical insurance is the largest cost item in the proposal, these alternate assumptions have a powerful effect on the total cost.

The final element in our cost analysis is the “ripple effect” -- the amount by which we anticipate wages of other, uncovered workers will go up as a result of the wage increases to those directly covered. We explain our method for determining these estimates in Section 4.

Tables 2.4 and 2.5 show our overall cost estimates. The combined cost of the mandated wages and benefits for service contracts and concessionaires is between \$28 and \$42 million, depending on the medical insurance cost assumption. Of this total, only about \$11 million goes directly to workers in the form of increased compensation. The reader should note that we have included a number of workers employed by non-profits (i.e. social service and childcare workers) in our estimates. We included these workers because our interpretation of the current version of the ordinance is that these workers are covered. However, the sponsors of the ordinance have told us that non-profits were meant in most cases to be

Table 2.4

¹³ To illustrate, we calculated this by multiplying the wage increase, \$1.32, times 2,080 (the number of work hours in a full year), time 3,900 (the number of covered FTEs).

Total Increase In Labor Costs For Service Contractors

| Type Of Cost | Amount of Increase | |
|---|---|---|
| | Mandated Health Plan Valued At \$2,000 | Mandated Health Plan Valued At \$4,000 |
| Increased Labor Cost to \$7.50 Per Hour | \$5,240,557 | \$5,240,557 |
| Increased Days Off for Workers Earning less than \$7.50/hour | \$1,630,611 | \$1,630,611 |
| Increased Health Benefits to Workers Under \$7.50 | \$3,551,214 | \$8,237,425 |
| Increased Days Off For Workers Above \$7.50 | \$1,696,084 | \$1,696,084 |
| Increased Health Benefits For Workers earning from \$7.50 to \$9.50 | \$2,869,124 | \$6,659,840 |
| Ripple Effect | \$531,304 | \$531,304 |
| Total Costs | \$15,520,894 | \$23,995,821 |

Table 2.5
Total Increase In Labor Costs For Concessionaires

| Type Of Cost | Amount of Increase | |
|---|--|--|
| | Mandated Health Plan Valued At \$2,000 | Mandated Health Plan Valued At \$4,000 |
| Increased Labor Cost to \$7.50 Per Hour | \$5,401,974 | \$5,401,974 |
| Increased Days Off for Workers Earning less than \$7.50/hour | \$1,952,360 | \$1,952,360 |
| Increased Health Benefits to Workers Under \$7.50 | \$2,753,755 | \$7,270,200 |
| Increased Days Off For Workers Above \$7.50 | \$578,321 | \$578,321 |
| Increased Health Benefits For Workers earning from \$7.50 to \$9.50 | \$915,892 | \$2,684,763 |
| Ripple Effect | \$373,177 | \$373,177 |
| Total Costs | \$11,975,479 | \$18,260,795 |

exempted. Exclusion of these persons would reduce our overall cost estimates by between 10% to 15%.

Finally, we include more lessees and concessionaires in our analysis than are included in the City Attorney’s working definition of coverage by the ordinance. Under the City Attorney’s present interpretation of the ordinance, covered concessionaires include: Airport food and beverage concessionaires; Recreation and Parks snack concessions, driving ranges, golf cart rentals, golf and tennis pros; and Harbor tugs and tours. Because this definition is still in flux, we broadened the City Attorney’s working definition above to include the following : Airport gift concessions; Harbor marina operations, restaurants and gift shops; and Recs and Parks restaurants and amusement concessions. We decided not to include some categories like Airport car rentals because the sponsors told us that they did not intend for the ordinance to cover these lessees. Because the bulk of the covered workers work in the Airport food and beverage category -- a category included in the City Attorney’s working definition -- the cost estimates for the City Attorney’s “narrow” interpretation and our “broad” interpretation do not vary greatly. Using the narrow interpretation of coverage of

concessionaires reduces the cost estimates for lessees and concessionaires by about 20% and the overall cost estimates by about 10%.

Discussion. What may be most striking to many readers is the substantial disparity between these cost figures and those published in other studies: the Riverside study, for example, came up with a total cost estimate of \$93.3 million, and the Carlson rejoinder, which used the \$93.3 million as a base before making adjustments, argued that this figure should be even larger. It is quite helpful to examine the sources of these differences.

The Riverside analysis estimated that firms covered by the Ordinance employed about 10,600 workers earning less than \$7.50 per hour. Our estimate is about half that size. There are two easily identified reasons why the Riverside estimate was higher. First, the Riverside authors concluded that several large economic assistance recipients were covered (the Ordinance, at the time the Riverside study was done, had a somewhat lower threshold for coverage as an economic assistance recipient.¹⁴ Second, the Riverside study apparently assumed (again, perhaps because of more inclusive language in the proposal they studied) that the Ordinance reached all low-wage employees of the covered firms, rather than just employees engaged in City-related work. If account is taken of these two differences, the Riverside estimate of covered workers would actually be significantly less than our estimate, though it is not possible to say exactly how much less.

Riverside's method of determining the number of low-wage workers at covered firms was quite different than our own method. The Riverside study did not rely on surveys of employers, but instead classified covered firms by industrial type and then used government data to analyze the distribution of worker wages at firms of that type. This approach had the advantage of not relying on the accuracy or completeness of employer-provided information on low-wage workers. It had the disadvantage of dealing with industry-wide averages, rather than the actual population of covered firms. The rough similarity of both of our estimates, when account is taken of changes in the Ordinance's coverage, bolsters our confidence that our estimate is roughly accurate and is certainly not (as the raw cost numbers might suggest) a substantial underestimate.

Aside from differences in the number of affected workers counted, the Riverside study also had three significant differences from our analysis in cost calculations. First, the Riverside study (again relying on government data) found that the "under \$7.50/hour" workers had average earnings of \$5.64 per hour; our employer-derived data showed an average wage of \$6.25 per hour. Riverside's lower wage estimate produced a higher Ordinance cost estimate.¹⁵ Second, the Riverside study estimated a dramatically larger

¹⁴ We are not certain that the Ordinance's language changes accounts for Riverside's inclusion of some economic subsidy beneficiaries. Our reading of the study suggests that they found some of these firms received large enough subsidies to be covered even under the current language of the Ordinance (see our section, below on economic assistance recipients).

¹⁵ There is something to be said for each finding. Our wage estimate fits better with well-documented patterns of general wage distributions for low-wage workers (i.e., the average wage of all U.S. workers earning between the minimum wage and \$7.50 per hour is close to \$6.25) and popped up consistently

“ripple” effect on higher-wage employees than we did. Although Riverside’s method for calculating the “ripple” effect was similar to ours in some ways, we believe that the authors applied the method erroneously. Third, the Riverside study assumed that health insurance coverage would cost \$4,000 if the employee did not currently have health insurance, and \$0 if the employee did have some coverage. They estimated that only 28% of the covered employees lacked health insurance, based on statewide statistics. Our method looked not only at who currently had health coverage, but how much the employer currently paid, and then measured the gap between current payments and the cost of either \$2,000 annual coverage or \$4,000 annual coverage.

The point of this discussion is twofold. First, there are concrete reasons for the differences in cost estimates between the Riverside study and our own; each estimate is based on a systematic methodology. Second, most of the difference in our estimates disappears if changes made to the Ordinance’s proposed provisions, after the Riverside study was begun, are taken into account. Third, nothing in the detailed differences of specific cost-estimating methods or results persuades us that our estimates are significantly off-target; on balance, our review of Riverside’s methods and findings strengthens our confidence in the estimates we have given in this section.

Economic subsidy recipients. One of the most controversial aspects of the Ordinance has been its inclusion of firms that receive economic assistance from the City of Los Angeles. The Mayor’s Office of Economic Development contends that this provision will make the City’s economic assistance programs deterrents rather than stimulants to new business entry and formation. Business leaders who oppose the bill have made similar arguments. As noted above, we concluded in our analysis that probably none of the current recipients of economic assistance from the City would be covered by the Ordinance as it is now written. The purpose of this section is to explain how we reached that conclusion.

In this realm of economic subsidies, the City did not provide us with the kind of survey data it compiled for a core of service contractors and lessees, and we did not try to conduct our own survey. What we gathered in this area, instead, was data on the types of economic subsidy programs that exist within the City, lists of recipients, and the likely applicability of the Ordinance to each program.

As discussed in Section 1, firms receiving economic assistance are not covered under the Ordinance unless they receive a subsidy of at least \$100,000 annually or over \$1 million at one time. Note that the amount to be measured is the net subsidy, not the gross level of assistance. Thus, firm receiving a \$3 million loan from the City with a ten years repayment schedule and an interest rate 2% below market would not be reached by the ordinance, because the subsidy is no more than \$600,000 (or \$60,000 per year, if measured as a flow over the life of the loan). Thus, by the standards of most city economic development

across a wide range of respondents; the Riverside estimate is not susceptible to misreporting by employers and is more consistent with data gathered by the Living Wage Coalition through interviews with a small sample of covered workers.

programs, this is a fairly high standard. As the examples in Table 2.6 illustrate, none of the programs we examined had any beneficiaries who were clearly above these thresholds.

Other aspects of this provision also limit its reach. The Ordinance apparently¹⁶ only applies to programs where the purpose of the economic assistance is economic development or job creation. This probably eliminates the City's substantial housing development programs, although economic development is arguably an ancillary purpose. The Ordinance is also cast in terms of financial assistance coming from the City itself. Read literally, this would imply that a corporation that receives the proceeds from an industrial revenue bond would not be covered, since the "subsidy" in such a bond is the lower interest rate that results from the bond's exemption from federal or state taxation. Similarly, a variety of City economic programs are largely pass-throughs of federal money. It is not only unclear whether such funds are considered city subsidies under the Ordinance; it is also possible that, for some programs at least, federal regulations would restrict the sorts of conditions placed on this assistance by the Ordinance.¹⁷

We thus conclude that few, if any current economic subsidy programs operated by the City would be covered by the Ordinance. It is certainly possible that future economic development efforts in Los Angeles could occur on a larger scale and be covered by the Ordinance. In later sections of this report (in particular, Section 9), we discuss the merits of retaining a largely theoretical coverage of economic assistance recipients in the Ordinance.

¹⁶ Sec. 10.37.1 (c). This limitation seems clear enough in the second paragraph of this subsection, but the subsection as a whole is somewhat ambiguous on this point.

¹⁷ The authors of the Ordinance are well aware of these issues, but no final interpretation of the Ordinance's reach has been determined yet.

Table 2.6
Summary of Some Key Economic Assistance Programs And
The Likely Reach of the Ordinance to Recipients

| Program | Mechanism | Reach of Ordinance |
|---|---|--|
| Department of Water & Power (DWP): Enterprise Zone discount | Firms that move or expand operations within designated enterprise zones receive 25% off some DWP charges | Hundreds of firms receive subsidies under this program, but according to DWP, the largest current participant in this program receives an annual subsidy of less than \$60,000. ¹⁸ |
| Community Development Bank | Provides loans and technical assistance to businesses in targeted geographic zones. | Only a handful of firms have yet borrowed funds under this new program, and only a portion of the assistance comes from the City. None of the loans to date are above the Ordinance thresholds. The only probable area of coverage would be the bank itself -- that is, the Ordinance might well apply to the staff of the bank. |
| Job Training Partnership Act | With federal funds, provides wage subsidies to displaced workers to help a prospective new employer cover the cost of retraining. | According to program administrators, JTPA participants are predominantly coming from relatively high skill jobs that pay more than \$10 per hour, and their wages under the program are generally at or above that level. |
| Industrial Development Authority bond program | Floats tax-free bonds under municipal immunity from federal or state taxation, and loans proceeds for private economic development projects | The subsidy in the bonds floated over the past year is below the Ordinance thresholds; in any case, subsidy is hard to characterize as City-based, rather than state or federal. |
| Section 108 Program | Similar to the IDA bond program; has specific job-creation requirements (one job for each \$30,000 in funding). | The subsidy in the bonds floated over the past year is below the Ordinance thresholds; in any case, subsidy is hard to characterize as City-based, rather than state or federal. |

¹⁸ It should be noted, however, that the Riverside study secured DWP data earlier this year; according to the study, this data shows four firms over the \$100,000 annual threshold.

Section Three: Productivity Effects of the Ordinance and the “Labor-Labor” Substitution Effect

One of the principal goals of the Ordinance is to increase the productivity of workers engaged in City business, and the quality of work performed for the City. There are four ways that such an improvement might occur: (a) if workers receiving the higher pay and better benefits increase work effort and become better employees; (b) if the pay and benefit increases, by reducing worker turnover, increase the average level of worker experience and cause the employer to invest more in worker productivity by providing more training; c) if the pay and benefit increases, by making the jobs relatively more attractive to the labor force generally, enable employers to hire “better” workers; or (d) if, at higher wages, employers require more effort from employees.

There has been some research suggesting that each of these effects occurs when pay goes up, at least to some degree. However, we believe that only (b) and © have really been firmly established by that research. Worker turnover does decline when wages go up,¹⁹ largely for the common-sense reason that when workers get a raise, they have a greater stake in their job. Lower turnover helps productivity primarily by reducing the number of inexperienced workers.²⁰

It is also well-established that employers gradually change the composition of their workforce when wages go up.²¹ This, again, is common sense: if a job suddenly pays more, then when employers advertise an opening, they will get more applicants and applicants with stronger “credentials” -- more years of schooling, more relevant experience, and so on. What is hard to measure is the rate at which this “substitution” of new workers for old workers will occur; much depends on the size of the wage change, the rate of attrition of old workers (recall that turnover has fallen), and the nature of the job. Usually, this effect -- known as the “labor-labor substitution effect” in the literature -- takes place gradually, but over the long-term has a significant impact on the human capital makeup of the workforce.²²

¹⁹ Richard Freeman and James Medoff, *What Do Unions Do?* (New York: Basic Books, 1984), Chapter 11.

²⁰ Lower turnover also helps to persuade employers to invest in training, since it gives employers a greater expectation that training they provide to their workers will not “disappear” quickly through turnover. However, most labor economists believe that employers generally make employees “pay” for some of their training in the form of lower wages. A wage floor can eliminate this possibility, and thus could offset the other incentive for training. It is unclear how these two effects “net out” on the training issue.

²¹ See, e.g., Daniel S. Hamermesh, *Labor Demand* (Princeton: Princeton University Press, 1993), Chapter 3.

²² Charles Brown, Curtis Gilroy, and Andrew Kohen, “The Effect of the Minimum Wage on Employment and Unemployment,” *20 Journal of Economic Literature* 524 (June 1982).

There is good reason for the City to take these productivity changes seriously. When the City contracts out for services, it is difficult to compare bidders on grounds other than price. Bidders may thus have an undue incentive to minimize on labor costs and provide lower quality services so that they have the lowest bid. Bidders that plan to use more or better quality labor may thus be frozen out of the competitive process. These situations are hard to correct if the City has poor information about service quality. Setting a minimum wage for service contract workers is thus a plausible strategy for setting service standards.

There are a few disadvantages to this strategy. First, an all-inclusive Ordinance probably reaches further than it needs to in pursuit of better productivity and higher quality. There may be areas where performance is easy to observe (e.g., landscaping) or where particular types of work are done well by low-wage workers. Second, it is difficult to know whether the City is getting its money's worth -- exactly because productivity gains in many areas are hard to observe, and there is reason to be skeptical of how much productivity could go up in jobs that inherently involve little training (e.g., parking attendants). Third, the labor-labor substitution effect can gradually displace many of the very workers that the Ordinance is trying to assist.

We conclude that the Ordinance is likely to produce tangible benefits for the City in higher productivity on service contracts. A more targeted Ordinance would probably reap these benefits more efficiently, however, while minimizing unintended side effects.

Section Four: “Ripple” Effects of the Ordinance

Economists who have analyzed the effects of minimum wages have noted that mandated increases tend to increase earnings not only of persons directly covered by the increase, but of those just above the new minimum.²³ For example, if a group of workers who are currently paid \$5.50 per hour is supervised by someone who is paid \$7.50 per hour, then a mandate increasing all the workers’ wages to \$7.50 per hour will probably produce a demand by the supervisor for a raise. If the job that used to be paid more highly is actually “harder” in some way, then that worker may not have an incentive anymore to take the more demanding position.

This “ripple” effect undoubtedly exists, and adds to the cost of the Ordinance. The interesting and more difficult question concerns the size of the ripple effect. The Riverside study (which called this the “wage contour” effect) assumed that the wage increases for workers earning under \$7.50 would have sizeable ripple effects: an average 15% increase for workers earning between \$7.50 and \$9.49 (about \$1.25 per hour),²⁴ and an average 7.5% increase for workers earning between \$9.50 per hour and \$11.50 per hour (about 80 cents per hour). These large effects substantially increased the Riverside study’s estimate of the Ordinance’s cost.

Our analysis suggests a much smaller ripple effect. The available labor market research suggests that when a new minimum wage increase goes into effect, the wages of those just above the new minimum tend to experience an increase no more than half the size of the increase received by workers at the bottom.²⁵ We can thus imagine a series of ripple effects, each half as large as the one before it, radiating up from the new minimum wage.

As we noted in the last section, the average wage of workers below the Ordinance’s \$7.50 living wage threshold is currently \$6.25 per hour; so the average increase for the workers actually covered by the ordinance is \$1.25. We assumed, therefore, that workers currently at a \$7.50 wage would see a wage boost, on average, that was half as large -- 62 cents -- to \$8.12 per hour. The employees that these workers “catch up” with would, in turn, see increases of 31 cents per hours, to \$8.43. Modeled in this way, the ripple effect peters out at about \$8.75 per hour. The average wage increase for workers in the \$7.50 to \$9.50 range, if this model is accurate, would be only 2.5%, rather than Riverside’s 15%.²⁶

²³ David Card and Alan B. Krueger, *Myth and Measurement* (Princeton: Princeton University Press, 1995), chapter 9.

²⁴ Pollin at 8-9.

²⁵ Card and Krueger report that in the 1990-91 increase in the minimum from \$3.25 to \$3.80, workers in the 5th percentile of hourly wage workers (essentially, those covered by the increase) experienced a rise in wages averaging 18% (roughly the amount of the increase), while workers at the 10th percentile (just above the new minimum) experienced a 7% increase in wages.

²⁶ The Riverside study’s methodology was not dramatically different from ours, but produced large differences in cost estimates because (a) the authors found an average wage of covered workers of \$5.64 rather than \$6.25, thus producing a much larger “ripple,” and (b) the authors assumed that the “ripple” would affect a much broader swath of workers in a fairly homogenous way.

Moreover, unlike the Riverside analysis, our analysis includes no increase for those in the \$9.50 to \$11.50 range. This is consistent with the Card & Krueger analysis showing that ripple effects only affect a small part of the wage distribution.

Our surveys of employers also give us a good handle on how many workers are in the wage range affected by the ripple effect. Combining these numbers with the analysis conducted in the last section, the model we just described would predict a ripple wage effect of about seven cents for every dollar in mandated wage increases (see Tables 2.4 and 2.5).

More complex models. The analysis we have just described is too simplistic in several ways. Let's briefly consider three complications:

1) Counting benefits in the ripple effect. Suppose that in our example above, the \$5.50 workers didn't have health benefits and the \$7.50 worker did. The Ordinance will give the \$5.50 workers both a wage increase and more benefits. This would make the ripple effect bigger, because the low-wage workers are getting a bigger increase. A bigger ripple will also extend further up the wage ladder before it tapers out. On the other hand, workers tend to pay more attention to their absolute and relative money wages than to their benefit packages, which would tend to make this factor less important.

2) Counting workers not engaged on the city contract. We have assumed in our model that the only workers directly affected by the ripple effect are other workers engaged on the same contract as the covered workers. This may be unrealistic. Employers may find it difficult to pay workers engaged in city business no less than \$7.50 per hour, while paying other workers \$5.75 per hour, or to have dual benefit systems. Of course, since much of the covered employment occurs on city property (e.g., a cashier at a LAX concession, or a janitor in the Central Library), and is thus physically separate from the employer's other operations, it might not be so difficult to maintain a distinct wage structure on the city contract; it's hard to say.

3) The labor substitution effect. As we discussed above, higher mandated wages will lead employers to gradually change the makeup and the nature of the covered jobs. Workers will probably be given more responsibilities, and perhaps more training; new hires will come to the jobs with higher skill levels. This will tend to reduce the ripple effect, because it reduces the substantive gap in skills and job demands between covered workers and uncovered workers, and thus reduces the need or justification for preserving a wage gap.

We think that all three factors are real, but we do not know how to measure them. Moreover, since these effects are largely peculiar to the "partial market coverage" of the Ordinance, earlier studies of general minimum wage increases are unhelpful. We take some comfort from the fact that the third effect cuts against the first two, reducing their collective impact on any estimate. We would be more concerned about our uncertainty if we thought that the effect was likely to be quite large, or if the core ripple effect played a major role in our overall cost estimate. As it is, we simply note that our ripple effect estimate is more speculative than our other cost estimates.

Section Five: Unemployment and Secondary Market Effects of the Ordinance

A common argument against minimum wage legislation is that it hurts low-income workers by raising unemployment. The economic argument is simple: wages reflect the marginal productivity of workers. If wages are forced up, then employers are asked to pay workers more than the worker generates for the employer, and many workers will consequently be laid off.

There has been a great deal of empirical research on how the theory translates into real labor markets, and the picture that has emerged is somewhat more complex. Much of the research focused on the “elasticities” of the demand and supply for low-wage labor. If the elasticity of demand and supply for labor were “unitary,” for example, then a 10% increase in the minimum wage would produce a 10% decline in employment. (Note that if this was true, the overall incomes of low-wage workers would remain virtually unchanged.) The research consensus reached by the mid-1980s was that the demand for low-wage labor was actually fairly inelastic, so that a 10% increase in the minimum wage produced a 1-3% drop in overall employment.²⁷ These figures are misleading in an important sense. Nearly all of the studies of the impact of minimum wages did not look at individual firms, but instead looked at the general level of employment among some groups of workers that typically earned something close to the minimum wage (e.g., teenagers). This aggregated employment data for an entire group included many individuals who actually earned more than the minimum wage.

The debate became more tumultuous -- and, for academics, more interesting -- with the 1994 publication of research by Princeton economists David Card and Alan Krueger, who conducted a careful empirical analysis of changes in employment in New Jersey and Pennsylvania fast food restaurants after New Jersey raised its minimum wage in 1990.²⁸ Card and Krueger found no net loss of jobs in New Jersey (and in some cases gains). They argued that classic “elasticity” analyses were flawed in examining very low-wage markets because the structure of these markets produced monopoly-like effects among employers.²⁹ Card and Krueger also argue that employment losses are mitigated by the “shock” effect of the increase in the minimum wage. According to this idea, firms that face a sudden increase in costs react by looking harder at ways to become more efficient. The problem with the

²⁷ Brown, *supra* note 22.

²⁸ Card and Krueger, “Minimum Wages and Employment: A Case Study of the Fast-Food Industry in New Jersey and Pennsylvania,” 84 *American Economic Review* 772 (1994).

²⁹ In a 1995 book that expands on these findings, *Myth and Measurement*, Card and Krueger resurrect the monopsony model of labor markets, which does in fact predict that within some range minimum wage increase will actually increase employment. There are two problems with the monopsony model. First, it requires either that firms in a labor market act in concert when setting wages or that workers are badly misinformed about alternative wage opportunities. Neither of these assumptions seem very plausible for most labor markets, and particularly not for the fast-food labor market on which Card and Krueger focus their research.

shock theory is that it would also seem to predict a decline in employment since more efficient firms can do less with all resources, including labor. The point here is that economists are still very much in disagreement as to how to explain the Card and Krueger findings and, thus, reluctant to assume that they can be widely generalized.³⁰

Nonetheless, Card and Krueger's research has convinced many labor economists that the unemployment effects of small increases in the minimum wage are quite small. This was highly relevant to the national debate on raising the minimum wage, and probably helped to carry the day for minimum wage advocates this year. This research is less relevant, however, to an increase like that proposed in the Los Angeles Ordinance, because the wage increase under the Ordinance is much larger. The New Jersey wage hike lifted a worker making the minimum of \$4.25 to \$5.05, an increase of up to 20% which brought low-wage workers from roughly the 2nd percentile of the income distribution to the 6th percentile. The Los Angeles Ordinance would give a worker at the current minimum (\$4.75) a raise of 58%,³¹ though the typical \$6.25/hour worker's increase would be closer to 20%. Moreover, since the Ordinance also requires benefit increases, the total compensation of workers (and the effective cost to employers) would be still higher -- 30% to 40% for most workers. Finally, since the place of these workers in the income distribution also rises more significantly (\$7.50 an hour would place them around the 25th percentile of hourly workers), the unusual dynamics of the bottom-end market studied by Card and Krueger are less applicable.³²

The size of the Ordinance's wage increases therefore suggests that, as a general matter, the unusually low unemployment effects found in Card and Krueger's research will probably not apply here. But are there other special circumstances that make the context of this Ordinance different? Yes, there are. The reason these employment losses happen is because when wages go up, three things tend to happen: employers try to get each employee to do more work than before; employers substitute machinery for labor; and the overall demand for the employer's product goes down (as prices increase), reducing the need for workers. Before directly transferring the general economic finding about employment effects to the specific contexts covered by the Ordinance, one should think about these contexts. Are these work sites where machinery can be substituted for labor, or where a few higher-skilled workers can do the work previously done by more lower-skilled employees?

³⁰ There is even some disagreement as to whether Card and Krueger got their numbers right in their initial article on the New Jersey fast-food industry. See Ronald Ehrenberg, ed., "Review Symposium: Myth and Measurement: The New Economics of the Minimum Wage," 48 *Industrial and Labor Relations Review* 827-49 (1995). We note that Card and Krueger's subsequent book does not rely on this one dataset, but contains an array of analyses that most commentators have found substantive and worth taking very seriously.

³¹ Note that since Proposition 210 has already mandated an increase to \$5.75 by next fall, that wage rate should probably be treated as the effective minimum, which would imply an increase of 30% in wages.

³² Card and Krueger agree; they note more than once in *Myth and Measurement* that they "suspect that, at sufficiently high levels of the minimum wage, the predicted employment losses of the standard model will be borne out." (p. 355)

Is the demand for city services going to decline if prices go up? The first question is an empirical one on which we have no original information. One can imagine that in some types of covered jobs, such as janitorial work, there are ways to increase the ratio of capital to labor (better cleaning machines) or hire fewer, more productive workers. In other types of covered work, such as a newsstand cashier, there may be very little substitution opportunity. What this means is that the unemployment effects are likely to vary across different work settings. Our assumption, however, is that on average, the work settings covered by the Ordinance will approximate the general market. The second question is still more difficult to answer, since it is largely a political question: would the City provide funding if the contracts cost more, or would it hold funding constant and, if necessary, accept declines in service? This turns out to be quite important. If the City “passes through” all increases in contractor costs to its own budget, employers would not have to make any tradeoffs to economize on costs, and the unemployment effects would be much smaller.³³ If the City holds contracting costs constant and accepts some declines in service, the unemployment effects would be relatively large. In this analysis, we will develop estimates corresponding to each of these assumptions.

The Secondary Market. The Ordinance only applies, of course, to a small part of the Los Angeles labor market. In this sense it is fundamentally different from conventional minimum wage legislation, which typically applies to 85% or more of the labor market and tends to cover all labor markets within particular industrial or service categories. This distinction between “partial” and “predominant” coverage has important practical implications for the effects of the Ordinance. If nearly all of a labor market is covered by the minimum wage, then persons who lose their jobs because of the higher wage simply remain unemployed. If only part of a labor market is covered, however, workers who are displaced by the higher minimum look for jobs in the rest of the economy -- the secondary market.³⁴

If workers displaced by the Ordinance look for work in the secondary market, it is obvious from a theoretical point of view what the general effects will be. With the number of workers competing for jobs in the secondary market going up, wages paid to workers (aside from those already at the statewide minimum) will go slightly down (very slightly, if, as here, the secondary market is far larger than the covered market). The lower wages cut two ways. First, they produce somewhat higher employment in the uncovered market (just as higher wages in the covered market produce less employment). This means that most of the displaced workers find other jobs, though sometimes these new hires displace existing workers. Second, even the slightly lower wages in the uncovered market could offset some of the gains to workers in the covered market and affect the overall income transfers to low-wage workers.

³³ Employers paying the higher wage would still have an incentive to substitute capital for the now higher-paid labor, so there might still be unemployment effects.

³⁴ Neither the Chicago nor the Riverside studies mentioned this effect, but there is a significant literature on secondary market effects in areas where part, but not all, of an occupation is unionized.

One possible twist to the account above occurs if some displaced workers choose to “wait” in the covered market for a job opening at the minimum wage. If these “wait-unemployment” effects are important then there will be less pressure downward on wages in the uncovered market but net displacement will be higher because some workers wait for the better paying jobs to open up rather than choose to become absorbed into the uncovered market. An important assumption of the wait-unemployment model, which is controversial, is that it assumes that a worker cannot look for a job in the covered market while working in the uncovered market. In any case, both the “pure spillover” account and the “wait unemployment” account predict less employment overall but have different predictions about what happens to the wage in the uncovered market.

Estimating the Unemployment Effect. How do these complexities translate into actual, concrete estimates of the unemployment effects of the Ordinance?

- Because the size of the wage and benefit increases mandated by the Ordinance is large, and pushes workers significantly up the income distribution ladder, the conventional assumptions about displacement effects of a minimum wage apply here.
- There is enough variation in estimates about the elasticity of labor demand and labor supply to justify using several different estimates. By using a range of empirically derived estimates of these elasticities, we can produce as in Table 5.1, “high”, “low” and “best” estimates of these effects. These elasticities are the best estimates of experts who have carefully reviewed the empirical literature.³⁵
- Because the Ordinance only covers a tiny fraction of the market, however, one must apply these same elasticities to the uncovered, “secondary” market, where most of the displaced workers are hired by uncovered firms.

³⁵ Ehrenberg, in his widely used labor economics text, reports that the conditional elasticity of demand is probably in the range of $-.15$ to $-.5$ and that the unconditional elasticity of demand (which is the appropriate measure in this case) may be as high as $-.75$ (See Ronald G. Ehrenberg and Robert S. Smith, *Modern Labor Economics* (New York: Harper Collins, 1991), chapter 4 at 115). We, therefore, use $-.25$ to $-.75$ as the range of possibilities and use $-.50$ -- the midpoint -- as our “best” estimate of the unconditional elasticity of demand. Studies of the elasticity of labor supply consistently find that the supply of labor is very inelastic. Prior to 1990, a consensus estimate was probably $.1$ (See John Pencavel, “Labor Supply of Men: A Survey” in *Handbook of Labor Economics, Volume I* (New York: North Holland, 1986)). An influential 1991 study of the labor supply of low wage men found a labor supply elasticity of $.30$ (See Chinhui Juhn, Kevin M. Murphy and Robert H. Topel, “Why Has the Natural Rate of Unemployment Increased Over Time?”, *Brookings Papers on Economic Activity*, 2:1991). The likely figure is somewhere between the old $(.1)$ estimate and the Juhn et al estimate of $.3$. Therefore, we use an elasticity of supply of $.20$ throughout.

- The response of the City to increased costs experienced by contractors is quite important in determining the overall unemployment effects.
- The cost of health insurance under the Ordinance (of which we provided two estimates of in Section 2) is also important in determining unemployment effects; more workers will be displaced if costs are higher.

Table 5.1 shows how these factors interact to produce particular unemployment effects under the Ordinance. We first show the unemployment effects if the City responds to these contracts the way a private business or consumer would respond to an increase in the cost of a particular service -- partly by paying more, and partly by buying less. Under this assumption, our best guess is that the Ordinance would displace 956 workers if the a \$2,000 health insurance policy satisfies the Ordinance (see Section 2 for an explanation of this figure), and 1,316 workers if a (\$4,000 health insurance policy is effectively required by the Ordinance). Of these workers initially displaced, about 275 workers would not regain employment in the uncovered sector under the modest health plan and about 375 workers would not regain employment under the more generous health plan. The reader should keep in mind two caveats. These numbers could be higher if some of the displaced workers choose to “wait” in the covered sector for a position to open up and will be lower if the city “pays” for the higher costs either by raising additional revenues or reducing the amount spent on other contracts that do not involve low wage workers.

A crucial assumption in the upper part of Table 5.1, which we now relax, is that the City’s response to the increase in contracting costs is concentrated on the firms utilizing low wage labor. Such an assumption is reasonable for profit-maximizing entities but may not carry over to not-for-profit entities like municipal governments. Instead, the increase in costs may get spread over a greater range of City contracts, or the City might decide as a matter of policy to absorb most of the higher costs. In this case, the disemployment effects for low wage workers will be considerably smaller. In the bottom row of table 5.1, we assume that the increase in contracting costs are spread over the entire range of city contracts. In this case, the overall reduction in employment of low wage workers is considerably smaller, about 58 for the modest health plan and about 75 for the more generous health plan. The reader should keep in mind that although the spreading of contracting costs reduces the reduction in employment for low wage workers, the overall disemployment effects, taking into account the effects on higher paid workers, will be similar to what has been discussed above. In other words, unless revenues increase or transfer programs are reduced, workers either directly or indirectly employed by the City will lose their jobs in the approximate numbers specified in our first scenario.

Table 5.1
 Predicted Employment Effects of Living Wage Ordinance

| | | | | Displaced Workers in the Covered Market | | Net Reduction in Employment Displaced Workers Not Absorbed Into the Uncovered Market) | |
|---|--|---|----------------------|---|----------------------|---|----------------------|
| | Elasticity of Demand in the Covered Market | Elasticity of Demand in the Uncov'ed Market | Elasticity of Supply | Modest Health Plan | Generous Health Plan | Modest Health Plan | Generous Health Plan |
| Predicted Effects if the City's Response to Increased Contract Costs Focuses on Covered Firms | | | | | | | |
| Low | 0.25 | 0.25 | 0.2 | 478 | 658 | 210 | 290 |
| Best | 0.5 | 0.5 | 0.2 | 956 | 1316 | 275 | 375 |
| High | 0.75 | 0.75 | 0.2 | 1,434 | 1974 | 301 | 414 |
| Predicted Effects on Low Wage Workers if Costs Are Spread Across All City Contracts | | | | | | | |
| Best | 0.1 | 0.5 | 0.2 | 192 | 263 | 58 | 75 |

Income Effects in the Secondary Market. Given the limited coverage of the Ordinance, the secondary market effect is quite powerful in offsetting direct unemployment effects. However, there is a negative side-effect: in order to absorb these additional workers, average wages in the secondary market must decline very slightly. We think it likely that this reduction will nontrivially offset the wage gain to covered workers. To see why, assume for illustration an elasticity of labor demand equal to one in the secondary market, so that a 1% increase in employment occurs if the wage decreases by 1%. With this assumption, the total wages paid in the uncovered low wage labor market must remain constant to absorb any additional workers and, therefore, average wages must decline slightly. This slight decline in average wages, under the assumption that the elasticity of labor demand equals one, would reduce the net transfer to low wage labor by an amount equal to the payments made previously to displaced workers.

We used a two-sector model of labor markets, a variety of elasticity parameters and different assumptions about cost spreading to see if there were any clear patterns of the magnitude of this offset, and found that there was not: the results varied from almost no offset to complete offset. Given the sensitivity of the outcome to the actual parameters,

including the City's response to higher contracting costs, we think it is simply too speculative to estimate how large the offset will be. However, this analysis is a reminder that the amount of income transferred to low wage workers by the proposed ordinance depends importantly on how the City responds to an increase in contracting costs. If the City allows cost pass-throughs on affected contracts, then both the reduction in employment will be low and the transfers to low wage labor will be high. If, however, the City does not allow cost pass-throughs, then the employment reduction will be significantly higher and the transfer to low wage labor will be significantly lower.

Section Six: The Income and Poverty Effects of the Ordinance

Both the Chicago and the Riverside studies assumed that all of the workers covered by the Living Wage proposals would be low-income workers. This assumption had the effect of increasing the “anti-poverty” impact of the proposals, but also produced a powerful side-effect: the loss of other government benefits. Both studies predicted that this side-effect would be large -- approximately 30 or 40 cents in lost benefits (including in-kind benefits like food stamps and Medicaid) for every dollar in higher wages. The Carlson study argued that, because of both benefit losses and tax increases, workers would only receive 15 cents for every dollar of mandated wage and benefit increases.

We believe these analyses are wrong in two important respects. If the statistical analysis described in this section is correct, most of the low-wage workers covered by the Ordinance are not living in poverty households, and the participation rate of these workers in social programs is less than complete. As a result, both the number of people in poverty affected by the Ordinance, and the loss of government benefits resulting from its higher mandated wages and benefits, are much lower than prior analysts have assumed.

We base these conclusions on the analysis of data from the Current Population Survey (CPS), an in-depth study of some 65,000 households undertaken by the Census Bureau on a continuous, rotating basis. The CPS uses in-person interviews to collect a wide range of data on individual wages, other sources of household incomes, taxes paid, and personal demographic characteristics. We secured data from the March 1996 CPS for the entire United States, and analyzed low-wage workers in the United States generally, and in Los Angeles County in particular. The principal reason for including national as well as local data is the relatively small sample sizes involved in purely local analyses. The number of Los Angeles workers in the 1996 CPS with hourly wages under \$7.50 is only around two hundred. Tables 6.1 and 6.2 show this data for these two populations.

What these tables show is that a majority of low-wage workers are not the sole or even principal source income in their household or family. Of those low-wage workers who do not live alone, less than one-quarter are the only wage earner in their family. The average low-wage worker’s earnings make up less than one-third of the family’s total income. As a result, most low-wage workers do not live in families that are below the poverty line. In Los Angeles County this year, about 22% of the low-wage workers lived in poor families (e.g., less than \$16,000 for a family of four); another 22% lived in near-poor families (e.g., between \$16,000 and \$24,000 for a family of four). The data does also suggests that this incidence of poverty is higher in Los Angeles than in the nation as a whole -- nationally, only 32% of the low-wage workers are part of poor or near-poor families. This is not surprising, because there is a higher-than-average concentration of low-wage jobs in Los Angeles, many of them filled by recent immigrants. In other words, fewer of the low-wage jobs in Los Angeles are taken by suburban teenagers; more are taken by inner-city heads of households.

Tables 6.3 and 6.4 show more precisely the family income distribution of low-wage workers in the United States and Los Angeles County. These tables break the family income distribution into ten equal deciles; families in the first decile have incomes that place them in

the bottom ten percent of the total distribution; families in the tenth decile have incomes that place them in the top ten percent of all families. This data shows that, while low-wage workers are more heavily lumped near the bottom of the income distribution than other workers are, they are nonetheless spread across all income levels. Essentially, low-wage workers in high-income families are “secondary” workers in their families, whereas in low-income families they are the principal earner.

Table 6.1
 Characteristics of Los Angeles Workers with Low-Wage Jobs, March 1996

| | Characteristics of Los Angeles Workers | | |
|---|--|-------------------------------|-------------------------------|
| | All Workers | Workers with Wages Below 7.50 | Workers with Wages Below 9.50 |
| Individual Characteristics | | | |
| Female (%) | 47.7 | 50.1 | 48.4 |
| Nonwhite (%) | 25.0 | 22.5 | 22.8 |
| Hispanic (%) | 45.1 | 60.7 | 59.3 |
| Aged 16-19 (%) | 4.2 | 9.4 | 7.5 |
| Aged 20-24 (%) | 15.5 | 25.3 | 23.9 |
| Less than high school education | 24.4 | 40.8 | 36.9 |
| Family Characteristics | | | |
| Living Alone (%) | 25.6 | 23.5 | 24.0 |
| Only Wage Earner (%) | 42.4 | 40.4 | 40.7 |
| Family Income Last Year | \$40,616 | \$27,316 | \$29,315 |
| Family Received Welfare Last Year (%) | 3.3 | 6.4 | 5.4 |
| Family Received Food Stamps Last Year (%) | 4.1 | 8.4 | 6.8 |
| Family Poor (%) | 10.2 | 21.6 | 18.7 |
| Family Near Poor (%) | 11.6 | 22.2 | 20.1 |
| Labor Market Characteristics | | | |
| Employed in Retail Trade | 21.2 | 31.4 | 29.5 |
| Average Hourly Wage | \$10.60 | \$4.99 | \$5.80 |
| Average Weekly Hours | 37.7 | 36.2 | 36.3 |
| Average Weekly Earnings | \$405.30 | \$178.90 | \$210.00 |
| Share of Weekly Family Earnings | 0.55 | 0.47 | 0.50 |
| Average Earnings Last Year | \$20,279 | \$8,528 | \$10,184 |
| Share of Total Family Earnings Last Year | 0.66 | 0.58 | 0.60 |

Table 6.2
 Characteristics of U.S. Workers with Low-Wage Jobs, March 1996

| | Characteristics of U.S. Workers | | |
|---|---------------------------------|-------------------------------|-------------------------------|
| | All Workers | Workers with Wages Below 7.50 | Workers with Wages Below 9.50 |
| Individual Characteristics | | | |
| Female (%) | 52.5 | 66.5 | 59.6 |
| Nonwhite (%) | 17.5 | 19.7 | 19.3 |
| Hispanic (%) | 10.3 | 13.4 | 12.5 |
| Aged 16-19 (%) | 7.8 | 16.2 | 7.9 |
| Aged 20-24 (%) | 13.7 | 21.7 | 19.8 |
| Less Than High School Education | 15.5 | 25.7 | 22.2 |
| Family Characteristics | | | |
| Living Alone (%) | 20.0 | 20.2 | 20.3 |
| Only Wage Earner (%) | 36.1 | 35.8 | 35.9 |
| Family Income Last Year | \$43,511 | \$33,325 | \$34,723 |
| Family Received Welfare Last Year (%) | 2.5 | 4.2 | 3.7 |
| Family Received Food Stamps Last Year (%) | 5.0 | 9.0 | 7.7 |
| Family Poor (%) | 8.0 | 16.5 | 13.2 |
| Family Near Poor (%) | 8.3 | 15.0 | 13.1 |
| Labor Market Characteristics | | | |
| Employed in Retail Trade | 22.8 | 36.4 | 32.1 |
| Average Hourly Wage | \$10.29 | \$5.10 | \$5.99 |
| Average Weekly Hours | 37.57 | 34.8 | 35.74 |
| Average Weekly Earnings | \$385.14 | \$174.03 | \$212.26 |
| Share of Weekly Family Earnings | 0.50 | 0.40 | 0.43 |
| Average Earnings Last Year | \$19,492 | \$8,554 | \$10,494 |
| Share of Total Family Earnings Last Year | 0.61 | 0.52 | 0.55 |

Table 6.3
Distribution of Low-Wage Workers Across the U.S. Family Income Distribution

| | Status of U.S Workers By Family Income Decile | | | Percentage of U.S. Workers in Each Decile By Wage Rate | |
|----------------------|--|--|--|--|--|
| | All Workers | Workers Making Below \$7.50/hr. | Workers Making Below \$9.50/hr. | Workers Making Below \$7.50/hr. | Workers Making Below \$9.50/hr. |
| Family Income Decile | | | | | |
| 1 | 4.5 | 8.4 | 6.6 | 63 | 69 |
| 2 | 6.8 | 12.5 | 10.7 | 63 | 75 |
| 3 | 8.4 | 12.0 | 11.9 | 49 | 68 |
| 4 | 10.2 | 12.9 | 12.8 | 43 | 60 |
| 5 | 11.4 | 11.9 | 12.5 | 36 | 52 |
| 6 | 12.4 | 11.0 | 12.3 | 31 | 47 |
| 7 | 12.7 | 9.6 | 10.4 | 26 | 39 |
| 8 | 12.8 | 8.4 | 9.1 | 22 | 34 |
| 9 | 11.9 | 7.7 | 7.9 | 22 | 32 |
| 10 | 8.8 | 5.7 | 5.7 | 22 | 31 |

Table 6.4
Distribution of Low-Wage Workers Across the Los Angeles Family Income Distribution

| | Status of Los Angeles Workers By Family Income Decile | | | Percentage of LA. Workers in Each Decile By Wage Rate | |
|----------------------|---|---------------------------------|---------------------------------|---|---------------------------------|
| | All Workers | Workers Making Below \$7.50/hr. | Workers Making Below \$9.50/hr. | Workers Making Below \$7.50/hr. | Workers Making Below \$9.50/hr. |
| Family Income Decile | | | | | |
| 1 | 6.8 | 11.7 | 9.3 | 55 | 61 |
| 2 | 8.2 | 17.9 | 14.8 | 69 | 80 |
| 3 | 8.1 | 9.4 | 10.1 | 37 | 55 |
| 4 | 11.7 | 11.4 | 13.1 | 31 | 50 |
| 5 | 11.9 | 16.7 | 16.0 | 45 | 60 |
| 6 | 8.6 | 8.4 | 8.6 | 31 | 44 |
| 7 | 10.4 | 7.5 | 8.0 | 23 | 34 |
| 8 | 11.5 | 7.5 | 7.4 | 21 | 28 |
| 9 | 14.8 | 4.9 | 6.6 | 11 | 20 |
| 10 | 8.1 | 4.6 | 6.2 | 18 | 34 |

Since most low-wage workers are not poor, it is also the case that the government benefits lost by workers (and saved by other units of government) are much smaller than the other analyses suggest. This is an important result, since the net “drain” on the local economy caused by this loss of benefits was perhaps the most important criticism leveled by the Chicago study against the Living Wage proposal advanced there. In fact, our analysis of CPS data, which includes data on each surveyed workers’ government benefits, suggests that the loss of benefits is still smaller. The Chicago and Riverside studies both assumed³⁶ that every worker currently in poverty received the full benefits to which he or she was legally entitled, and that benefits would fall according to the schedules of each program (which generally have high marginal tax rates). This assumption is not true; even many of those workers whose families are eligible for social benefits do not participate in the programs. This may be particularly true in Southern California, since many of the low-wage workers

³⁶ Tolley et al., at 27-28; Pollin et al., at 51-52. Our impression is that the Riverside study apparently did this to play devil’s advocate, and didn’t embrace this assumption as firmly as the Chicago study did.

here are Latino, and Latino participation rates in social welfare programs tend to be substantially lower than participation rates among Anglos and African-Americans.

To develop precise estimates of how wage increases would affect the receipt of welfare benefits and the payment of taxes, we again used 1996 CPS data. We measured the average benefit and tax amounts in the households of workers whose hourly wages fell in specific intervals: \$4 to \$6 per hour; \$6 to \$8 per hour, and so on. The results are shown in Table 6.5.

Table 6.5
Average Means-Tested Benefits Received and Taxes Paid By Low-Wage Workers
(California CPS, March 1996)

| Benefit/Taxes | Wage Interval | | | |
|-------------------------------|-----------------|-----------------|-----------------|-------------------|
| | \$4.00 - \$5.99 | \$6.00 - \$7.99 | \$8.00 - \$9.99 | \$10.00 - \$11.99 |
| EITC | \$312 | \$258 | \$179 | \$84 |
| Food Stamps | \$183 | \$97 | \$59 | \$34 |
| Medicaid | \$426 | \$363 | \$271 | \$210 |
| Energy | \$5 | \$4 | \$2 | \$2 |
| Educational | \$389 | \$326 | \$251 | \$238 |
| Housing | \$7 | \$5 | \$2 | \$2 |
| School Lunch | \$110 | \$85 | \$68 | \$52 |
| Federal Taxes | \$1127 | \$1814 | \$2622 | \$3610 |
| State Taxes | \$157 | \$285 | \$440 | \$641 |
| Total Average Benefits | \$1,433 | \$1199 | \$832 | \$624 |
| Total Average Taxes | \$1,284 | \$2099 | \$2862 | \$3609 |

What do these data imply about the effect higher wages and benefits will have on the net income of low-wage workers? From the table, we can calculate the marginal loss in benefits and increase in taxes for each added dollar of income workers receive. For example, if an individual moves from the midpoint of the first wage category (\$5 per hour) to the midpoint of the second wage category (\$7 per hour), then, on average, that person’s benefits will decline \$234 (i.e., \$1,433 - \$1,199) and that person’s taxes will increase by \$815 (i.e., \$2,099 - \$1,284). Since the person’s income is going up \$2 per hour, or roughly \$4,000 per year, our prototypical worker is losing about 6% of the increased income to benefit losses, and is losing about 21% of the increased income to higher taxes -- a total marginal loss of 27%. This would suggest that workers receiving wage increases under the Ordinance would,

on average, lose about 27% of the increase to lower benefits and higher wages, and would keep 73%.

This oversimplifies the total picture, however, because much of the increased compensation received by workers under the Ordinance is in the form of benefits -- health insurance and time off -- which are not taxed or counted in determining eligibility for government benefits (except for Medicaid). For the typical worker covered by the Ordinance who is earning less than \$7.50, the total compensation provided by the Ordinance comes to about \$2,000 in higher wages and about \$2,500 in benefits.³⁷ Since most of the increased compensation comes in the form of untaxed benefits, the net loss of higher compensation to other levels of government is only about 20%.³⁸

If one also considers that more than half of the workers who are covered by the Ordinance do not receive any wage increase at all, but only increases in benefits (health insurance and time off), the net loss of mandated compensation under the Ordinance to other levels of government is still lower. If one takes our estimates of total compensation costs from Section 2, and applies the analysis we have outlined here, it follows that of the total \$26.5 million in increased compensation expenditures by employers, about \$3.8 million, or 13%, would go to reducing government benefits of workers and increased taxes.

The fact that a program contributes to workers receiving fewer government benefits and paying higher taxes is, of course, a good thing from the standpoint of national well-being. In a federal program, such indirect revenue effects are an important offsetting revenue benefit to contemplated economic or social welfare initiatives. The problem with a similar initiative launched at the local level is that an individual city can only recapture a fraction of the increased revenue and cost savings its efforts generate. The findings in this section are therefore quite important in assessing the overall effects of the Ordinance. Because a relatively small portion of the expenditures under the Ordinance are “lost” to other levels of government, the direct and indirect economic impact of these losses is also much smaller than earlier studies have suggested.

In summary, we find that the Ordinance would have only a modest impact on poverty among covered workers, chiefly because most of these workers are already above the poverty line. If one counts only the cash income received by workers, the Ordinance would reduce the poverty rate among covered workers earning less than \$7.50 per hour from around 20%

³⁷ This assumes that the cost of health insurance mandated by the Ordinance will be \$2,000 per worker, not \$4,000; if the higher figure applies, of course, then the marginal “loss rate” on mandated wages and benefits is even lower.

³⁸ This assumes that the provision of health insurance by employers results in a loss of Medicaid to those persons who are currently receiving it.

to 5-10%,³⁹ thus raising several hundred workers above the poverty line. If one “imputes” the value of benefits to workers, the reduction in poverty is somewhat larger.

Targeting the anti-poverty effect. The incidence of poverty among low-wage workers varies substantially across occupations. The low-wage “suburban teenager” is likely to work in a fast-food chain; the low-wage child care worker is more likely to be the primary breadwinner for her family. Table 6.6 shows the poverty and “near-poverty” rate among workers in Los Angeles who have low wages and work in some of the principal occupations covered by the Ordinance.

Table 6.6
Los Angeles Poverty Rates by Occupation For Those
With Wages Less Than \$7.50 Per Hour

| Occupation | % Below Poverty Line (\$16,000 for a family of four) | % Below 150% of the Poverty Line (\$24,000 for a family of four) |
|----------------------|---|---|
| Janitors | 26% | 49% |
| Landscaping Workers | 28% | 48% |
| Security Officers | 20% | 36% |
| Parking Attendants | 26% | 51% |
| Child Care Workers | 38% | 57% |
| Cashiers | 19% | 32% |
| Food Service Workers | 18% | 30% |
| Receptionists | 18% | 31% |

Source: 1990 PUMS data, adjusted for inflation to 1996 dollars.

This data confirms that poverty rates do vary substantially among those covered by the Ordinance. It would be possible to increase the anti-poverty effects of the Ordinance (per dollar spent) by targeting coverage towards contracts employing workers with a higher incidence of poverty.

³⁹ Not all covered workers would rise above the poverty line because many of the workers are employed part-time, others are in large households with higher poverty thresholds, and still others will lose some cash benefits like the EITC.

Section Seven: Paying The Costs of the Ordinance

Previous studies have sharply divided on the question of who would end up paying the higher labor costs mandated by the Ordinance. The Chicago study, relying on microeconomic theory, found that the City of Chicago would end up absorbing the full cost of the higher wages paid by service contractors.⁴⁰ The Riverside study argued that very little of the higher wages in the Los Angeles Ordinance would be passed on to the City,⁴¹ for two reasons: (a) the more highly-paid workers would be more efficient, thus offsetting some of the cost of their higher wages; and (b) for most of the firms covered by the Ordinance, the City contract represents a small part of their total operations and the added costs could thus be easily absorbed. The Riverside study therefore recommended allowing cost pass throughs only for firms for which the City contract represented a large proportion of the firm's total revenues,⁴² amounting to a total pass through equal to about one-fifth of the wage and benefit increases.

In the only direct empirical research generated on this question, the Baltimore study examined the contracting costs of many of the covered firms in Baltimore the year after that city's Living Wage Ordinance was adopted.⁴³ The Baltimore authors found no net increase in contracting costs.

We have not conducted any new empirical research on this issue, but have instead reviewed these studies and other economic research to assess what is likely to happen. We cannot claim any startling insights on this question, but we can suggest some tentative conclusions, which can be perhaps best conveyed by commenting on the three analyses we just summarized.

The Chicago study has its microeconomic theory right. In theory, firms that are contracting with the City do so only because they can earn a market-rate profit on the contract. If costs go up, then firms will be, at the margin, indifferent between passing the costs on to the City or abandoning the contract. Of course, firms that are earning higher-than-average profits on their contracts or that have sunk costs linked to the contracts will have an incentive to keep the contracts despite the higher costs; but these firms will still try hard to pass the costs through to the City, and if they were successful in the past in capturing above-market profits, there is no *a priori* reason to think they won't be successful again. Thus, economic theory predicts that there will be some immediate pass through in costs, and, over the long term, a nearly complete pass through to the City.

⁴⁰ Tolley et al at 22.

⁴¹ Pollin et al at 35.

⁴² More exactly, firms for whom the City contract represented more than 10% of the firm's total business, with the percentage pass-through increasing with the "share of business" percentage.

⁴³ Mark Weisbrot and Michelle Sforza-Roderick, *Baltimore's Living Wage Law* (The Preamble Center for Public Policy, Wash., D.C.), Oct. 1996, at 7-10.

One of the Riverside responses to this theory -- the idea that firms will simply absorb the higher costs if the City contract and/or the higher costs are a small part of their total operation -- seems to us wrong. If a city contract is a small part of a firm's business, the firm is not going to transfer productivity savings from other parts of its business to subsidize the city contract. Big firms analyze the profitability of each segment of their operations and jettison those that are unprofitable. If anything, firms that derive a large portion of their revenue from a city contract are more likely to try to find ways to avoid a pass through of costs, since more of their overhead and sunk costs are likely to be dependent on retaining that contract. But of course, even these firms will need to find some way, over the long term, of offsetting those costs: through an eventual rise in the contract amount, by lowering the quality of performance, or by increased efficiencies.

This brings us to the second Riverside argument: that high labor costs will bring greater efficiency.⁴⁴ We think this is undoubtedly true, at least to some extent, as discussed in Section 3; higher pay is likely to lead to more productive workers. The critical question is how large this effect will be. Unfortunately, very little is known about this issue. There has been much interest by labor economists in "efficiency wage" theory -- the notion that higher wages lead to greater effort by workers and higher productivity -- but no empirical research showing that firms that could benefit from higher wages are not, in fact, paying such wages. The lack of research is partly due to the rarity of scenarios in which a large exogenous wage increase is suddenly given to a large group of workers. One can at least say, then, that the Ordinance would provide an excellent opportunity to test the efficiency wage theory.

However, few proponents of efficiency wage theory believe that it will offset all of the costs of higher wages.⁴⁵ How, then, can one account for the Baltimore study results, which found no change in the City's contract costs during the first year of the living wage's operation? We think that the Baltimore study is an example of the kind of primary research that should be used to determine the effects of policies like living wage ordinances, and we think their findings are sufficiently intriguing for pause. Still, we do not think they are sufficiently strong to rebut a presumption that employment will decline and city contracting costs will increase because of the ordinance. In several respects, as the authors acknowledge, their data is incomplete (mostly, it seems, because of unavailability of much data at the time of their study). They had no information on how many workers actually received higher wages as a result of the ordinance (though they said the number was "fairly small"), and thus had no estimate on the total cost increase that needed to be absorbed.⁴⁶ Some of the contracts declined sharply in price, suggesting that there may have been changes in the composition of

⁴⁴ Pollin et al at 37, 38.

⁴⁵ Assuming that the costs could be fully offset this way would suggest, among other things, that employers generally set wages at irrationally low levels.

⁴⁶ This, of course, is essential to determine what "cost increase" pressure was potentially created in given contracts by the new law.

services provided by the contract. And 80% of the total contract value covered by the study was accounted for by a single contract (for school bus services). Finally, the study looked at contracting cost only a year after enactment of the ordinance; the employment effects are likely to take longer than that to be fully felt.

The most puzzling aspect of the Baltimore study, however, is the authors' finding that employment did not decline among any of the contractors as a result of the Living Wage law.⁴⁷ If contracting costs are contained because of increased efficiencies among workers,⁴⁸ then the cost savings imply employment losses -- fewer, more highly-paid workers doing the same work done by more, lower-paid workers before. (Such a tradeoff, of course, increases the secondary market effects we discussed in Section 5.) But if there are no employment losses, where are the cost savings realized? The only remaining possibility is that contractor profits are lower.

We noted above that economic theory would predict some decline in contractor profits in the short term. However, the size of the Baltimore effect suggests that something else could be going on. One possibility is that contracting inefficiencies by the government are large enough -- and the average amount of above-market profits are great enough -- so that there is "room" in contractor profits to absorb the extra costs of the proposal. This change, in the direction of increased efficiency in the contracting process, could occur if two conditions are met: (a) existing contract procedures do not do a good job of minimizing contract costs; and (b) some change occurs in the contracting process at the same time the "living wage" provisions go into effect so that contracting becomes more efficient. We have no knowledge that either of these conditions were met in the Baltimore case.

Could contracting efficiencies be achieved in Los Angeles? We have no concrete evidence that they can be. The City is currently engaged in efforts to streamline its methods of procuring goods -- an analogous activity -- and the premise of this effort is that significant economies can be realized through this process. It seems possible that similar economies could be realized in the service contracting process. An analysis of this issue was beyond the scope of the study, but it seems well worth examining regardless of whether the Ordinance is adopted.⁴⁹

We conclude, then, that the service contractors covered by the Ordinance might absorb some of its cost in the short-term, but will not do so in the long-term unless (a) the

⁴⁷ As noted earlier, this might simply be a misleading result, because of the lack of controls on covered workers or the timing of the study. In the discussion that follows, we take the finding at face value and explore its possible implications.

⁴⁸ The Baltimore authors join the Riverside authors in believing this will happen, and the Baltimore study quotes a contractor who observes this effect in his own firm (though this contractor had unilaterally raised wages before the Living Wage ordinance went into effect).

⁴⁹ We were struck in doing our research by the decentralized nature of service contracting. There is, for example, no central place where data on all contracts is gathered.

current contracting process is inefficient enough to permit contractors excessive profits, and (b) the contracting process is reformed when the Ordinance is adopted. It is certainly worth finding out if these conditions can be met, but the City should not count on them. It is more likely that the City will face the burden of meeting the costs created by the Ordinance. It can do so in three ways: by finding increased revenues; by spreading the costs across all service contracts (that is, slightly reducing services across the board) or substantially reducing services in the covered contracts.

All of this discussion has focused on service contractors. Most of what we have said applies to concessionaires as well, but with an important added complication: higher costs facing concessionaires could be partially passed to consumers. It is reasonable to think that in these contexts, consumers will bear a substantial fraction of the cost, some concessionaires will close because consumers will not bear the costs, and the City will absorb some of the cost in lower leases and permit fees.

Section Eight: Multiplier and Community Effects

We have already discussed how the Ordinance could have indirect effects on the general Los Angeles labor market. An important, and still broader question, concerns the extent to which the Ordinance, in providing higher wages and benefits to covered workers, may produce overall increases or decreases in economic activity in Los Angeles, and the degree to which these changes might be concentrated in particular neighborhoods. These effects are generally referred to by economists as regional or neighborhood “multiplier” effects.

It is worth initially noting that any multiplier effect from the Ordinance will, as a practical matter, be too small to be picked up by even the most sensitive economic seismograph. As documented earlier, the total reach of the Ordinance appears to affect fewer workers than the Riverside study estimated. Moreover, since the Ordinance essentially creates a transfer program, with the City and local businesses paying more funds to local workers, most of the money paid to local workers comes from local sources -- a sort of “zero-sum” process that tends to negate any net economic stimulus or drag on the economy. There are, indeed, significant transfers among workers themselves, as our discussion of unemployment and secondary market effects in Section Five suggests.

The principal way that the Ordinance could help or hurt the general regional economy is if it affects the flow of resources to and from the region. The main way this could happen is through changes in the volume of benefits received or taxes paid to the state or federal government. As we discussed in Section Seven, the Ordinance as currently structured would cause produce, among workers receiving higher compensation, a total loss of state and federal benefits and an increase in state and federal taxes in the neighborhood of \$4 million. This outflow might suggest that the net effect of the Ordinance on the economy is slightly negative. However, this outflow may be offset in two ways. If some of the cost of the Ordinance is borne by businesses, rather than the City government, the higher expenses they incur will reduce company profits and, thus, corporate or sole proprietorship taxes. Similarly, if some of the businesses are partly owned by out-of-state parties, the business-borne costs would reduce the flow of profits to those individuals. Measuring either of these effects would be highly speculative, and we decline the temptation to make a guess. It is certainly conceivable, however, that these reductions in outflows from the region (lower business taxes paid and lower profits to out-of-state parties) could approximate, overall, the \$4 million loss noted above. In all likelihood, these factors significantly offset one another.

Our conclusion, then, is that the Ordinance is unlikely to have either a significant positive or significant negative effect on the economy of either Los Angeles or the broader metropolitan region. Any net effects would be too small to take very seriously as a reason to support or oppose the Ordinance.

The “Community” Effect. Can we expect that any positive or negative “multiplier” effects from the Ordinance would be concentrated in particular Los Angeles neighborhoods? Overall, we think that any such effects will be extremely small. We have three reasons for reaching this conclusion:

1) The net income transfers to low-wage workers under the Ordinance are quite modest. As we have noted elsewhere, most of the higher compensation going to workers is in the form of benefits, not wages (about \$11 million is in the form of wages). A fifth of the wages is lost in lower benefits and higher taxes. Some low-wage workers are displaced, and although most find other jobs, the effect of increased competition in the low-wage secondary market probably slightly depresses wages. After these effects are taken into account, the net money income transfer to low-wage workers as a class is probably less than \$5 million.

2) Low-wage workers are not heavily concentrated in low-income neighborhoods of Los Angeles. This seems very counterintuitive until one recalls our earlier finding that only one-sixth of workers with wages below \$7.50 per hour are from families below the poverty line. Since these workers are not heavily concentrated at the bottom of the family income distribution, we should not expect them to be heavily concentrated in low-income communities. (Unemployment and joblessness, in contrast, *are* heavily concentrated in low-income communities.)

Tables 8.1 and 8.2 show the distribution of low-wage workers across Los Angeles neighborhoods, broken into five quintiles based on mean family income. We developed this table from the 1990 Census’ Public Use Microdata Sample, which has detailed data on worker earnings and is available for moderate-sized geographic areas (Los Angeles County is divided into 56 such areas). This data is far from perfect, since it is six years old, the areas (called Public Use Microdata Areas, or PUMAs) are larger than neighborhoods and often internally diverse, and since one must impute hourly wages from the earnings data.⁵⁰ Nonetheless, it is probably the best available measure of how low-wage workers are distributed across the Los Angeles metropolitan area. The first PUMA quintile roughly represents the poorest fifth of neighborhoods in Los Angeles County -- areas where the average wage of workers is less than \$10 per hour. However, this “fifth” of the county is home to only 26% of the Los Angeles workers earning less than \$7.50 per hour. Nineteen percent of these workers live in the most affluent quintile. In other words, the beneficiaries of the Ordinance are not heavily concentrated in low-income parts of the City.

3) Just as the multiplier effect in a metropolitan area is smaller than it is in a large nation, the multiplier effect is smaller yet in a neighborhood. Most of what an individual buys does not translate into wage gains for the consumer’s neighbors. This is obviously true for housing expenditures; the vast majority of housing expenses go to owners and financial institutions outside the community. Even grocery purchases at a local store have a limited

⁵⁰ We did this by dividing total wage and salary earnings for individual workers by their total “weeks worked” the year before multiplied by “usual hours worked per week”. This produces a rough hourly wage.

economic impact on the immediate community, since most of each dollar spent at the store pays for the products the grocer buys from producers outside the community; only the fraction of the dollar that goes to employee wages is likely to come back to the community.⁵¹

Each of these three considerations should make us skeptical of the potential of the Ordinance to disproportionately benefit particular communities.

⁵¹ This is not intended as a critique of the general theory of local economic multipliers. Such multipliers clearly can exist at the level of “neighborhood reinvestment” -- where, for example, a new commercial development spurs other commercial development. Our point is that increases in the income of an individual resident has only a very small additional effect on the aggregated income of the resident’s community.

Table 8.1
Distribution of Workers Earning Less Than \$7.50 Per Hour
Across Los Angeles Neighborhoods, 1990

| PUMA Quintile | Mean Hourly Wage and Salary Earnings | Percentage of Workers In Affected Sectors Whose Mean Hourly Earnings Are Less Than \$7.50 | Percentage of Covered Workers in Each Region | Number of Workers Affected By Possible Increase (per 1,000 Workers) |
|---------------|--------------------------------------|---|--|---|
| 1 | \$9.95 | 32% | 26% | 2.14 |
| 2 | \$10.94 | 26% | 19% | 1.79 |
| 3 | \$12.50 | 24% | 18% | 1.53 |
| 4 | \$13.86 | 22% | 18% | 1.48 |
| 5 | \$17.10 | 18% | 19% | 1.19 |

Table 8.2
Geographic Distribution of Workers Earning \$7.50 - \$9.50

| PUMA Quintile | Mean Hourly Wage and Salary Earnings | Percentage of Workers In Affected Sectors Whose Mean Hourly Earnings Are Less Than \$9.50 (but More than \$7.50) | Percentage of Covered Workers in Each Region | Number of workers Affected By Possible Increase (per 1,000 Workers) |
|---------------|--------------------------------------|--|--|---|
| 1 | \$9.95 | 7% | 18% | 1.48 |
| 2 | \$10.94 | 8% | 18% | 1.70 |
| 3 | \$12.50 | 8% | 21% | 1.78 |
| 4 | \$13.87 | 8% | 20% | 1.65 |
| 5 | \$17.10 | 7% | 23% | 1.44 |

Source: 1990 Public Use Microdata Sample

Section Nine: The Effect of the Proposed Ordinance on the Los Angeles “Business Climate”

Perhaps the single greatest concern expressed by organizations that have spoken out against the Proposed Ordinance is its putative effect on the regional business climate. This really breaks into two distinct types of arguments. The first argument is that businesses will incur greater costs because of the ordinance, and will therefore reduce their investment and economic activity in Los Angeles. The second argument is that business investment will be deterred, not by the direct effects of the ordinance but instead by the “signal” the ordinance will send that Los Angeles is hostile to business, and that other, more onerous measures will follow in the future. These are two very different arguments, and we will address them separately.

Direct Incentive Effects of the Proposed Ordinance. Under what conditions would a contractor with the City of Los Angeles, who was faced with the requirements of the Proposed Ordinance, decide to reduce its business operations in Los Angeles? Very few, we think. As we noted in Section 7, the increased labor bill resulting from the proposal will be absorbed in several different ways: somewhat higher productivity among workers, some reduction in workforces, absorption of costs by contractors in situations where the contractor has been collecting economic rents, and, over the long term, the pass-through of the residual costs to the City. All contractors, we think, will continue to receive at least a market-rate profit on their city contracts since, if they do not, they will rationally choose not to do the contract and the City will contract with someone else (perhaps at a higher rate). The only way a “reduction” in economic activity can occur is if cost pass-throughs to the City run up against budget constraints, and lead the City to conclude that some particular service cannot be provided.⁵² It is highly unlikely that such scenarios will produce a net decrease in City spending, however, since other alternatives will be found. So while it is likely that the Proposed Ordinance would cause some changes in the composition of city contractors, it does not seem at all plausible that the total amount of city spending on contracts, or the economic activity of contractors, will decline. Nor is there any reason to fear a net migration of contracting firms out of the City, since nothing in the Ordinance provides direct incentives or disincentives to operate in a Los Angeles suburb rather than in the City itself.

Much the same story applies to licensees and lessees of the City, such as airport concessionaires. As we have discussed, it seems even more likely that in these cases, costs that are created by the Ordinance would be passed on -- partly to consumers in the form of higher service prices, partly to some laid off workers, partly to businesses capturing economic rents, and partly to the City in the form of lower lease payments. The net effect on total economic activity at these sites is unlikely to decline measurably.

⁵² Here we are talking about “direct” reductions in economic activity from the Ordinance. Given the secondary effects we have discussed elsewhere, there could be a net overall reduction in economic activity in the local economy, though it would be fairly small -- even relative to the program.

The situation is different with economic subsidy recipients, however. The point of economic subsidies is to encourage new investment and job formation in the City. The theory behind these subsidies is that if investors are trying to decide whether to locate in central Los Angeles or in, say, Carson (or is trying to decide whether to start up a firm at all), the economic subsidy provided through a city program can tip the balance towards creating a business in the City. The added cost of higher wages can tip the balance the other way, especially since, unlike contractors, economic subsidy recipients will ordinarily not have the same ability to pass costs along to the City. In an effective subsidy program, the City's assistance is not intended, of course, to "pay" for the long-term employment of workers to do particular tasks. An efficient subsidy leverages a relatively large private investment by filling some temporary gap in the businesses' ability to turn a profit at a particular location or with particular workers, and enables the businesses to become self-sustaining over a short period of time. A permanent increase in costs tied to an economic subsidy can substantially change the cost equation for the prospective business investment. Moreover, many of these subsidies are not structured in a way that makes it easy to simply expand the subsidy to cover the added worker compensation.

As we saw in Section 2, the point of some of the economic subsidy programs, such as the Community Development Bank, is to increase economic activity in very poor sections of Los Angeles. The labor market that these new businesses are intended to recruit from are people with short work histories and long bouts of unemployment. Workers recruited from this labor market are often receiving useful training from employers, both in specific job skills and more general "employment" skills. Because it can be somewhat more costly for firms to employ these workers, paying wages below the \$7.50 threshold is a method of having the workers bear some of their training cost.

All of this suggests that application of the Ordinance to economic subsidy programs risks more serious, inadvertent harms than is the case with coverage of service contractors or concessionaires. We view it as a good thing that the Ordinance does not appear to currently cover any economic assistance recipients (though a few may be covered that we missed). The coverage that is written into the Ordinance -- covering recipients of very large subsidies -- is not tailored to avoid the problems we have described, so that if a firm does at some point fall under the Ordinance's coverage, the Ordinance could have negative and inadvertent effects on the subsidy program's goals. We conclude that the Ordinance should either have a blanket exemption for economic subsidy recipients, or should be revised to capture situations where the subsidy program's goals are consistent with the operation of the Ordinance.

Indirect, "Climate" Effects of the Proposed Ordinance. Would the Ordinance have a general chilling effect on the Los Angeles business climate, discouraging firms from migrating to Southern California and encouraging existing firms to consider expanding or relocating elsewhere? We are quite skeptical about such an effect. For one thing, the scale of the proposal is tiny in comparison to the Los Angeles economy -- some \$30 million in a county-wide economy of some \$200,000 millions. For another, the indirect effects of the proposal on the Southern California wage market, to the extent that it has any effect on employment not covered by the proposal, is in the direction of reducing rather than raising labor costs. The multiplier effects we have analyzed are also negligible.

Most importantly, the Proposed Ordinance does not place meaningful burdens on businesses. Coverage is entirely voluntary, in the sense that businesses that choose not to contract with the City (and the vast majority of businesses in Southern California do not) are not affected by its provisions. Businesses that do contract with the City choose to do so only after negotiation, and, as noted above, will only enter into those contracts if they can make a normal profit on the transaction.

It seems to us that regulations of city contracting procedures are going to be perceived by the business community very differently than regulations of the private sector in general. The Ordinance does not create generalized costs to “doing business” in Los Angeles. Consequently, negative effects from the proposal can only stem from perceptions that it is only the “entering wedge” of broader interference in the private market, or that it signifies a revitalized and aggressive labor movement in Los Angeles. For example, if businesses believed that the Ordinance was the first part of a campaign to adopt a city-wide minimum wage affecting all private firms, that might affect the business climate.⁵³

Even here, however, we would register two caveats. First, there are certainly affirmative things the City can do to affect how the Ordinance, if adopted, is perceived by business, such as emphasizing its limited reach and its effect in improving the quality of some City services. Second, the empirical research on this question suggests that business climate effects are very modest, if they exist at all. The best research we have found is a Michigan study that interviewed several hundred business executives, and gathered information on hundreds of business location decisions, to determine how attitudes about business climate are formed, and how these attitudes relate to actual locational decisions.⁵⁴ The study found no statistically probative relationship between the climate views and locational decisions.

We are therefore skeptical of claims that the Ordinance would have significantly negative effects on the general Los Angeles business climate.

⁵³ A City-wide minimum wage would, of course, be quite different from the Ordinance and would probably impose serious costs on the local economy.

⁵⁴ Schmitt, Gleason, Pigozzi and Marcus, “Business Climate Attitudes and Company Relocation Decisions,” 72 *Journal of Applied Psychology* 622 (1987).

Section Ten: Administrative issues

The primary determinants of the shape and cost of any program administration strategy flow from the answers to three policy questions, which in the present case are: (a) How seriously is the Ordinance to be implemented and enforced? (b) Will enforcement rely on harsh penalties or broad monitoring? (c) Will administrative burdens be primarily borne by the City or by employers? We will discuss each of these briefly.

A great many social programs and policies are enacted without any serious implementation mechanism. Depending on the context, these initiatives may serve as a useful statement of public aspirations, or they may foster cynicism among the parties that are, in theory, regulated. A general mandate to City Departments to follow the provisions of the Ordinance, without any other administrative mechanism, would probably lead to the following practice: most Departments would require contractors and other covered parties to sign a certification that they are in compliance with the Ordinance. The affected businesses would soon learn that this was simply a formality, and most would pay no further attention to the Ordinance's requirements if the cost of compliance was significant.

Our assumption in the rest of this section, and indeed in the report as a whole, is that both proponents and opponents of the Ordinance are more interested in understanding the benefits and cost of the Ordinance -- including administrative costs -- on the premise that it would be seriously enforced.

Serious enforcement can still be relatively inexpensive, if there is some systematic oversight and if the penalties for violation are severe. A well-established principle in the study of compliance with the law is the tradeoff between the probability of detection and the severity of punishment: the lower one is, the higher the other must be to maintain a constant level of compliance. In the case of the Ordinance, one can imagine a gradation of possible City responses to noncompliance by covered parties: a request that the party comply; suspension of the contract or assistance until compliance occurs; termination of the contract and ineligibility of the offending party to do further business with the City under the program; or termination plus some civil penalty.

There is also a gradation of mechanisms for detecting noncompliance: requiring covered employers to give their employees (and post at the workplace) notices on their rights under the Ordinance and creation of a "hotline" for employees to notify the City of violations; random audits of covered employers at varying levels of frequency; requests for systematic documentation from employers, including federal payroll records; random interviews with covered employees; or annual audits of each covered employer.

The least expensive administrative method for the City would combine a low-intensity detection method with a high penalty for noncompliance. This approach is economically efficient, but it can also be unfair, since a few noncomplying parties get hit with severe penalties while other violators escape any punishment. More comprehensive monitoring methods can increase costs for both the City and for employers.

An important problem particular to enforcement of this Ordinance is the difficulty of monitoring hours of work. The paper records of employers could be quite deceptive about hourly compensation rates if the actual hours worked by covered employees are understated by, say, 20%. Many public contracts currently require contractors to keep “time sheets” of hours spent on the funded activity, and falsification of timesheets -- probably more often for reasons of administrative convenience than fraud -- is widely reputed to be endemic. Methods of compliance that rely on information from employees about their actual hourly rate and benefits, rather than just paper records, are probably be more reliable.

How can employer costs of compliance be minimized under the Ordinance? One strategy is to tie actual reporting requirements under the Ordinance as closely as possible to existing reporting requirements, such as the periodic listing of employees and individual employee compensation required of all significant employers by the State of California. If the format and timing of City reports is linked to other reports of this type, it will make reporting easier and will probably tend to increase its accuracy. For employers that currently provide no health insurance to employees, the City could also help to gather systematic information on group health plans that satisfy the Ordinance requirements and provide that data to employers.

It is also worth noting that the great majority of employers covered by the Ordinance are concentrated among a relative handful of firms. We recommend in our conclusion that the Ordinance actually be modified to focus on firms that, among other criteria, have the largest number of low-wage employees; but even if such changes are not made in the Ordinance, it would make sense, from the standpoint of minimizing both City enforcement costs and private compliance costs, to have much simpler reporting requirements for firms that have a relatively small number or percentage of workers covered by the wage and health insurance requirements of the Ordinance.

Given the various considerations we have discussed, the best administrative mechanism, in our opinion, would have the following characteristics: (a) efforts to make covered employees aware of the requirements of the Ordinance, and a mechanism to gather information from employees on employer compliance; (b) serious but not disproportionate penalties for noncompliance; (c) some type of random auditing program; (d) a two-tiered reporting structure (depending on the number of a firm’s employees covered by the Ordinance), with lower reporting requirements for firms with few covered employees, and forms tied into existing state forms and time-lines, to minimize employer burdens and paperwork.

We believe that a program of this type should not be very expensive for either the City or for employers. The Chicago study quoted an estimate that the cost of administering a Living Wage proposal in that city would be \$4 million annually. The Riverside study, extrapolating from administrative experience in San Jose’s prevailing wage ordinance, estimated that the administrative cost would be approximately \$600,000 for the City of Los Angeles. We have tried to “price out” the administrative mechanism described above, and we come up with City costs similar to, or lower than, the Riverside estimate (depending mostly on whether compliance focuses mostly on the firms with many covered employees).

We believe that a capable administrative unit with a budget of \$600,000 and the design features described here would be able to achieve a high level of compliance with the Ordinance. It is much more difficult to estimate the administrative costs for private employers, since the composition of employers and the ways they are affected by the Ordinance vary so greatly. Moreover, it is virtually impossible to verify how great these costs are if the Ordinance is enacted, since they are scattered across hundreds of businesses. Nonetheless, we believe that if our suggestions above are followed, the administrative cost for any one form would be quite low.

Section Eleven: Alternatives

In the debate over the Living Wage concept, an important option that has been overlooked is the federal Earned Income Tax Credit (EITC). The EITC was begun in the late 1970s and was greatly expanded by the Clinton Administration in 1993. The EITC works as a sort of “negative income tax” for low-income families with job earnings. A worker who is the sole support for her family, has two children and worked full-time in 1996 at an hourly wage of \$5.75 (the statewide minimum wage that will be in effect in a year) would be eligible for an EITC of roughly \$3,500 -- enough, in other words, to make her effective wage \$7.50 per hour. There is thus a mechanism already in place to achieve one of the Ordinance’s central goals.

The problem is that a majority of the Los Angeles residents who are eligible for the EITC do not know about it or do not use it. Even those who use it tend to receive the EITC in a lump sum when they file a tax return, even though the program now makes it relatively easy for employers to pass the benefit on to workers in the form of regular “wage subsidy” payments. We estimate that the total value of unused EITC benefits in the City is \$100 million per year.

From the City’s standpoint, the enormous advantage of an EITC over a Living Wage is that the EITC brings more outside funds into the metropolitan area, while a Living Wage tends to reduce the inflow of outside benefits and increases the outflow of taxes. Moreover, from a policy standpoint, the EITC is perfectly targeted at the neediest population: all of its benefits go to low-income families, and none of the EITC income is taken into account in determining the recipient’s eligibility for other means-tested benefits.

If the City takes steps to increase the use of the EITC by City service contractors, it can help achieve some of the other goals of the Ordinance. For example, if City contractors offer year-round wage supplements from the EITC to their qualified low-wage workers, they will presumably secure lower turnover from their workers and some of the other productivity benefits that the Ordinance seeks to achieve.

The EITC cannot achieve all of the goals of the Ordinance, such as the provision of health insurance to contract workers, or the establishment of “model employer” criteria. Moreover, many of the weaknesses of the Ordinance can be greatly mitigated by carefully targeting its provisions. The most significant quality issues that have arisen in service contracts are concentrated in particular areas (e.g., custodial and security contracts). Some types of contracts (e.g., for child care workers) hire low-wage workers with much higher concentrations of poverty than the average level. Low-wage workers are also concentrated in a relatively small number of contracts; if the Ordinance applied only to these high-concentration areas, administrative costs would be far lower.

We therefore set forth, in the “Summary and Recommendations” portion of this report, a specific proposal that lays out a path by which many of the goals of the Ordinance can be achieved at much lower cost. It is by no means certain that the scaled-down “Living Wage” proposal we outline can succeed in all of these goals; we have, for instance, little hard

information on the productivity problems or the exact effects of higher wages. But we think there is a good chance that the proposal would achieve its goals of increasing the quality of City services and transferring income to a substantial number of poor or near-poor workers. In this form, we think that any possible negative side effects of the Ordinance are virtually eliminated. The EITC proposal, for its part, is the sort of common-sense idea that has virtually no downside. With both proposals, we strongly recommend an evaluation mechanism for assessing whether the demonstrable benefits of the programs justify their costs over time.

Section Twelve: Conclusions

On the whole, we are surprised that we were able to answer as many questions about the Living Wage Ordinance as we did. Put as broadly as possible, our findings are these: The Ordinance's benefits and wages mandates would mostly affect a few hundred service contractors and concessionaires and around seven thousand employees. The total cost of the mandate would be around \$30-40 million; two-thirds of the cost would go to benefits rather than higher wages. There would be some indirect effects on higher-paid workers and the general economy, but both of these would be surprisingly small. A non-trivial number of covered workers would lose their jobs when the Ordinance's mandated wage and benefit increases went into effect, but most of these workers would find new jobs in what we have called the "secondary market." The City would probably end up paying most of the cost of the increase -- and should do so, if it wishes to minimize the displacement of workers. The Ordinance would have a positive effect on worker productivity and the quality of services provided to the City, but a more targeted Ordinance could gain most of those benefits at much less cost. The Ordinance would have a very modest effect on poverty among the affected workers; this too, could be made more cost-effective with better targeting. The Ordinance will not be a great boon to Los Angeles' low-income communities; neither is it likely to chill Los Angeles' business climate.

How these findings translate into support or opposition to the Ordinance in its current form, of course, depends on one's values and goals, and how one estimates the seriousness of the problems the Ordinance seeks to address. One might think that the tilt of the Ordinance's cost towards higher benefits is desirable, if one sees the absence of health insurance among low-wage workers as a critical problem. One might believe that the symbolic and service quality effects of the Ordinance easily justify its cost. Or one might conclude that the program is weak as an anti-poverty initiative and that the money could be used more effectively elsewhere.

Our intent is not to answer these difficult questions, but to provide a sufficiently detailed framework so that one can roughly determine how well the Ordinance, as drafted, meets various goals, and what is likely to happen if it is enacted. Our own recommendations follow from our interpretation of the Ordinance's goals. We believe that if the central purposes are seeking higher productivity, having the City set a positive example, and reducing poverty among the City's "shadow" workforce, then the program outlined in our summary would meet the goals more cost-effectively.

Appendix A

Notes on the Study Methodology for Surveying Firms

Given the potentially broad scope of the ordinance, it is essential to understand how many workers will be potentially affected under the various interpretative variations. The ideal methodology for estimating the number of workers affected is to survey the universe of contracts. Given the short time under which the present study was produced, a complete canvass of the universe was not feasible. A methodologically sound alternative would be to draw and survey a random sample from the universe of city contracts and leases. An important property of a random sample, and the property that makes it methodologically sound, is that all contracts in the universe have an equal probability of being chosen for the sample. Though scientifically valid, this property makes a true random sample an arguably inefficient data gathering procedure in cases where it is known beforehand that certain types of observations (i.e. contracts) are more likely to contain covered workers. To increase the reliability of the estimates in situations where one has strong beliefs that certain types of observations are more likely to contain relevant information, a strong case can be made for stratified sampling. Under a procedure of stratified sampling, the universe is first stratified according to the likelihood of containing relevant information and then the strata more likely to contain relevant information is more heavily sampled. In the context of this study, a method of stratified sampling would call for contracts and leases known to contain low wage labor to be more intensely sampled.

The procedures that we use for estimating the number of workers affected and overall costs uses a combination of stratified and random sampling. To obtain estimates for low wage workers working directly on city contracts we primarily used data obtained from the City for firms known to employ low wage labor. We supplemented the City-provided data with a random sample 650 contractors. Of the 650 firms in the random sample, fifty were also included in the City survey, and we did not resurvey them. Of the remaining 600, we successfully collected information from over 260 service contractors. Taking into account the information we collected from our random sample and the information we already had on firms in our random sample from the City Survey, we had data on 310 contractors of the original 650 firms in the random sample -- a response rate a little short of 50%, which is high for surveys that require a written response.

For most low wage sectors, we had data from the City on most of the universe for that sector. In a few cases where we did not have the complete universe of contracts, we adjusted our sectoral estimate up by a conversion factor that reflected what was included in the universe but not in the sample. In most cases, this conversion was based on the dollar value of contracts. In a small number of cases (for concessionaires), the relevant contract value data was not available and, we used the number of firms in the universe relative to the number in the sample to compute a conversion factor. To estimate the number of administrative support staff, social service workers and child care workers, we used the results of our random sample and the appropriate conversion factor. We used similar methods to estimate the number of affected workers and costs for lessees and concessionaires.

One obstacle that had to be overcome with the City-provided data is that it was not gathered in a way that always provided direct information on the number of workers in the relevant ranges and the average wages for workers in that range (i.e. relevant ranges being “workers making less \$7.50” and “workers making between \$7.50 and \$15.00”). Instead, the City gathered information on all workers making less than \$15.00. Over ½ of the observations fell within the relevant ranges and required no adjustment and most of the cases involved workers making between \$4.75 and \$9.50. For the observations where the workers surveyed overlapped the ranges, we used an algorithm that estimated the number of workers in each range using information from the survey on the maximum, the minimum and the average wage of all the workers surveyed. This algorithm broke down the workers on a given survey into those making less than \$7.50, those making between \$7.50 and \$9.50 and the averages for each range. As a check on this algorithm, we recomputed the mean wage of all workers in the survey implied by the algorithm and compared it to the actual mean wage. The algorithm computed an average wage within 2 cents of the actual mean.

Finally, we checked to make sure that our estimates were inclusive in two ways. First, we combed the universe for sectors that might have substantial low wage workers but for whom we had no data and surveyed these firms over the telephone. For example, in the sanitation sector where we had very little information, we called and talked to most of the firms with large contracts (over 5 million annually) and found that none we talked to had affected workers. An important exception in this sector of a firm that we were unable to gather information on was Browning-Ferris. Second, we used the random sample to derive a point estimate of the number of affected workers, excluding social service and child care workers. The point estimate is 1865 workers making under \$7.50 and 470 workers making between \$7.50 and \$9.50. These point estimates are similar to our reported estimates of 1917 for workers making under \$7.50 and somewhat less than our reported estimate of 1300 workers making between \$7.50 and \$9.50. The main reason for the discrepancy was the lack of information on food service workers in the random sample where many of the \$7.50 to \$9.50 workers are concentrated, leading to an underestimate for the point estimate, and additional information we gathered on firms not in the random sample (but included in our reported estimates) for administrative support staff employed by “low-wage” firms. Since both of our point estimates are less than the reported amounts, we believe that our numbers are roughly accurate and may in fact overestimate the number of covered workers.

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